Supreme Court, U.S.
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No. 01-

IN THE

Supreme Court of the United States

LAWRENCE EPSTEIN and JOHN LINDER,

Petitioners,

v.

MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF DELAWARE

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Petitioners seek a writ of certiorari from a Delaware Supreme Court ruling in a class action. That ruling declined to vacate a judgment as violative of due process, and plainly violates Supreme Court jurisprudence. The intertwined questions for this Court devolve largely into two categories. Both involve misapprehension of venerable legal concepts. The first involves the standards for adequacy of representation. Here, the questions are (a) whether a state court may constitutionally certify a class without any record evidence that the representatives are class members or of their adequacy; and (b) whether the presence of an "experienced" jurist and "experienced" and concededly conflicted counsel are constitutionally cognizable substitutes for record evidence of standing and of adequacy?

The remaining question assumes a lack of adequacy of representation, and is whether class members' right to opt out is a constitutionally sufficient substitute for adequacy of representation?

PARTIES TO THE PROCEEDING

The named plaintiffs in the federal class action, *Epstein, et al. v. MCA, Inc., et al.*, No. 92-55675 (C.D. Cal.), are Lawrence Epstein and John Linder (hereinafter, "petitioners"). Following the final determination of the federal action, petitioners sought to intervene and vacate the judgment in a Delaware proceeding, *In re MCA, Inc. Shareholder Litigation*, Consolidated C.A., No. 11740.

The respondents in the Delaware proceeding and herein are Matsushita Electric Industrial Co., Ltd., Matsushita Holding Corporation, Matsushita Acquisition Corporation, MCA Inc., Lew Wasserman, Sidney J. Sheinberg, Thomas V. Jones, Robert S. Strauss, Thomas Wertheimer, Howard H. Baker, Jr., Thomas P. Pollack, Felix G. Rohatyn, Howard P. Allen, Mary Gardiner Jones, Charles S. Paul, Seymour Lazar, A.J. Lou, Marion Lord, Sheldon Shore, Harry Osgood, Barnett Stepak, Julius Ostreicher, Thomas E. Acito, Darren Suprina, Sara Naphtali, Stephania Ziemak, Kenneth Pogrob, Elriede Glancy, Jacob Gottlieb and C. Christopher Muth, as Trustee for the Carl H. Muth Trust. Matsushita Acquisition Corporation no longer exists by virtue of having been merged into MCA Inc.

RULE 29.6 STATEMENT

All petitioners are individuals.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners respectfully petition for a writ of certiorari to review the judgment of the Supreme Court of Delaware in this case.

OPINIONS BELOW

The opinion of Delaware's Supreme Court is reprinted in the Appendix ("App.") at 1a-25a and is officially reported at 785 A.2d 625 (Nov. 16, 2001). The opinion of the Supreme Court of the United States is reprinted at 26a-59a, and is officially reported at 516 U.S. 367 (1996). The opinion of the Ninth Circuit following remand from the Supreme Court, dated October 22, 1997, is reprinted at 60a-116a, and is officially reported at 126 F.3d 1235 (9th Cir. 1997). The opinion of the Ninth Circuit, dated June 7, 1999, is reprinted at 117a-146a and is officially reported at 179 F.3d 641 (9th Cir. 1999).

JURISDICTION

The Supreme Court of Delaware rendered its decision of petitioners' appeal on November 16, 2001. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

U.S. Const. Amendment XIV provides in relevant part:

> . . . nor shall any state deprive any person of life, liberty, or property, without due process of law.

See Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 812 (1985) ("the Due Process Clause of course requires that the named

plaintiff at all times adequately represent the interests of the absent class members"), *citing Hansberry v. Lee*, 311 U.S. 32, 42-43 (1940).

STATEMENT OF THE CASE

A. Overview

Petitioners commenced a class action on behalf of shareholders of MCA, Inc. in the United States District Court for the Central District of California on December 3, 1990. The action asserted violations of the federal securities laws alleging the existence of a special deal between Matsushita and MCA's chairman and chief executive in connection with Matsushita's tender offer to acquire MCA. A separate class action had been commenced by other shareholders of MCA in Delaware Chancery Court. That action alleged that MCA and its directors had breached their duties to shareholders by not obtaining other bids for the purchase of MCA.

Only a week after the filing of the petitioners' federal action, the parties to the Delaware action announced that they had reached a global settlement of all state *and* federal claims arising out of the acquisition. The vice chancellor rejected the proposed settlement. *In re MCA, Inc. Shareholders Litig.*, 598 A.2d 687, 693-94 (Del.Ch. 1991) ("*MCA I*"). The vice chancellor noted that petitioners' federal securities law claims "have at least arguable merit and therefore have significant value," *id.* at 690, and that the state law claims were essentially meritless. *Id.* at 693-94. The vice chancellor found that the value of the proposed settlement was "illusionary" and that the value of the settlement - - a proposed revision to the poison pill of an MCA subsidiary - - was "apparently. . . proposed merely to justify a settlement which offers no real monetary benefit to the Class." *Id.* at 696.

While petitioners vigorously litigated the federal action, the Delaware action lay dormant for well over a year. The only litigation activity in the Delaware action was class counsel's efforts to derail the federal action.

The federal district court dismissed petitioners' action on the eve of trial, and petitioners appealed to the U.S. Court of Appeals for the Ninth Circuit. After petitioners filed their opening brief in the Ninth Circuit, the parties to the Delaware action announced another settlement of that action. This second settlement purported to resolve the state *and* federal claims for approximately $2 million (2-3¢ per share) less $575,000 in attorneys' fees and expenses. The Delaware Chancery Court approved the settlement though the Delaware plaintiffs and the class counsel presented *no evidence* of adequacy of representation, and as the Ninth Circuit later put it, provided "hostile representation [to the class] that served the interests of counsel in getting a fee," *Epstein v. MCA, Inc.*, 126 F.3d 1235, 1255 (9th Cir. 1997) ("*Epstein II*") (App. 103a), and provided a "misleading and incorrect analysis" of the federal litigation claims. *Epstein v. MCA, Inc.*, 179 F.3d 641, 653 (9th Cir. 1999) ("*Epstein III*") (App. 141a). The Chancery Court's opinion did not mention adequacy of representation, but noted that "suspicions of collusion" abound. Nevertheless, that court approved the settlement because *objectors* had not offered any evidence of collusion. *In re MCA, Inc. Shareholders Litig.*, 1993 WL 43024 at *5 (Del. Ch. February 16, 1993) ("*MCA II*").

The Ninth Circuit then rendered summary judgment for a plaintiff class notwithstanding the Delaware judgment that purported to bar those claims. *Epstein v. MCA, Inc.*, 50 F.3d 644 (9th Cir. 1995) ("*Epstein I*"). The judgment has a potential value now in excess of $2 billion. This Court reversed, holding that the Delaware judgment (in which class members received approximately a penny per share) was entitled to full faith and

credit, but left open whether Delaware processes satisfied due process. *See Matsushita Elec. Indus. Co., Ltd. v. Epstein*, 516 U.S. 367 (1996) (App. 26a-59a). Initially, the Ninth Circuit concluded that in Delaware class counsel had provided inadequate representation. "This was not merely 'inadequate' representation," wrote the court, " it was hostile representation that served the interests of counsel in getting a fee. . . ." (App. 103a). On rehearing, the Ninth Circuit remained "troubled by the substance of the Delaware Settlement," (App. 134a) but reversed itself and in a 2:1 decision held that the adequacy of representation issue had been fully and fairly litigated and necessarily decided in Delaware. Therefore, the Delaware judgment merited preclusive effect. App. 133a, 135a. Plaintiffs then petitioned Delaware to vacate the judgment.

The Delaware Supreme Court acknowledged that there was no record evidence whatsoever that the plaintiffs had standing, much less were adequate class representatives. App. 19a. The court also recognized that the class counsel who were advocating a local settlement that would extinguish the federal claims had a conflict of interest. App. 24a. It also explicitly found that, contrary to the decision of the Ninth Circuit, "[t]he objectors who appeared at the settlement hearing did not litigate the adequacy of [plaintiffs and counsel's] representation." App. 19a. Yet, Delaware's Supreme Court held that the settlement satisfied Delaware class action process and by extension those of the Constitution. How could it arrive at such a startling departure from obvious and venerable constitutional principles?

The court reasoned that the facts that the vice chancellor was "an experienced jurist" (App. 24a) and the conflicted class counsel too was "experienced" (App. 20a) were constitutionally satisfactory substitutes for the due process requirement that absent parties are not bound by a judgment *in personam* without adequate representation. The Delaware judgment was

then utilized to extinguish the valuable summary judgment in a federal proceeding.

In substance and in effect, the decision stands for the proposition that the rights of parties, in class or other representational proceedings, can be determined in their absence so long as counsel, even conflicted counsel, and the court have experience in the subject matter of the litigation. What follows indicates also that in addition to its degradation of the most fundamental due process considerations, the matter presented to this Court implicates significant financial consequences for the many persons to the federal proceedings whose rights to a share of upwards of $2 billion would be destroyed by the penny per share to which the Delaware decision would confine them.

B. The Federal Class Action

This securities law class action arose out of respondents' takeover of MCA. Alleging violations of the Exchange Act, which are within the exclusive jurisdiction of the federal courts, 15 U.S.C. § 78aa, petitioners instituted a proceeding in a California federal district court on December 3, 1990. The federal district court denied petitioners' motions for class certification and partial summary judgment and ultimately dismissed the federal claims. Petitioners' appealed to the Ninth Circuit from these rulings.

C. The Delaware Class Action And Its Interferences With The Federal Proceedings

1. *The First Delaware Settlement.* On September 25, 1990, respondent Matsushita announced that it was negotiating a possible acquisition of MCA, Inc. The next day, several shareholder class actions were filed in Chancery Court in Delaware.

Once the federal complaint was filed, the district court was informed that the Delaware class action asserting only state law claims had been settled and that the settlement purported to compromise petitioners' federal claims. App. 49a-50a. (Ginsburg, J.). Rejecting the proposed settlement as "illusionary," the vice chancellor characterized the state law claims as "at best, extremely weak," and as having "little or no value." *MCA I*, 598 A.2d 687 *supra*, at 694, 696 (Del. Ch. Apr. 22, 1991). He added that "the only claims which have any substantial merit are the claims. . . in the California federal suit that were not asserted in this Delaware action." Id. at 696.

2. *The Second Delaware Settlement.* After petitioners had filed their opening brief in the Ninth Circuit, another settlement in what had been the completely "dormant" (App. 51a, Ginsburg, J., concurring) Delaware proceeding was announced.

Though stating that the benefits to the class were "meager" and that "suspicions [of collusion] abound," the vice chancellor approved the settlement as an exercise of his "own business judgment in deciding whether the settlement is reasonable . . ." (citation omitted). *MCA II*, *supra*, 1993 WL 43024 at *4, 5, 3. In submitting this settlement to the Chancery Court, Delaware class counsel, among other failures, provided no evidence of adequacy of representation or standing of any of the plaintiffs. There was no evidence submitted to assure conflict-free representation by class counsel. The vice chancellor did not address the issue of adequacy of representation and instead said that the three individual objectors had not proved collusion. *Id.* The individual "objectors who appeared at the settlement hearing did not litigate the adequacy of their representation", as the Delaware Supreme Court later held. App. 19a.

D. The Federal Appeals

1. *Epstein I.* In the Ninth Circuit, defendants offered the Delaware judgment for its preclusive effect. 28 U.S.C. § 1738. The Ninth Circuit reversed the district court's dismissal on the merits, granted plaintiffs partial summary judgment on liability, and ordered class certification. 50 F.3d 644 (9th Cir. 1995). The court refused to give the Delaware judgment full faith and credit because that judgment compromised claims within exclusive federal jurisdiction. Defendants petitioned for, and this Court granted, certiorari limited to the exclusive jurisdiction issue.

2. In *Matsushita Electric. Industrial Co., Ltd. v. Epstein*, 516 U.S. 367 (1996), this Court framed the issue before it as follows:

> This case presents the question whether a federal court may withhold full faith and credit from a state-court judgment approving a class-action settlement simply because the settlement releases claims within the exclusive jurisdiction of the federal courts.

App. 26a-27a. The Court unanimously answered that question in the negative.

Because the case was limited to that threshold question, the Court expressly declined to consider petitioners' due process objection to the preclusive effect of the Delaware judgment based upon inadequate representation:

> We need not address the due process claim, however, because it is outside the scope of the question presented in this Court. . . . While it is true that a respondent may defend a judgment

> on alternative grounds, we generally do not address arguments that were not the basis for the decision below. (Citations omitted.)

App. 37a, n.5. Once again, the Court was unanimous.[1] While three concurring justices (Ginsburg and Stevens, J.J., joined on this issue by Souter, J.) discussed the issue of adequacy of representation at length (App. 46a-59a), they too left that issue for further consideration on remand. App. 59a (". . . this is a court of final review and not first view. . .").

3. *Epstein II.* On remand, a divided panel of the Ninth Circuit concluded that the Delaware judgment could not be given preclusive effect because both Delaware law and federal constitutional law prohibit enforcement of a judgment rendered in a class action proceeding in which the interests of absent class members were not adequately represented. App. 104a.

In an opinion for himself and Judge Wiggins, Judge Norris concluded that the issue of adequacy of representation by Delaware class counsel had not been "litigated" in Delaware (App. 69a); that even if it had been raised by the three appearing individual objectors, Delaware preclusion law would permit a collateral challenge by an absent class member; and finally, that in any event the due process clause required inquiry into adequacy of representation before the Delaware judgment could be given preclusive effect. App. 104a. Judge Norris focused at length on the inadequate representation by Delaware class counsel: "This was not merely 'inadequate' representation, it was *hostile* representation that [only] served the interests of counsel in getting a fee . . ." (emphasis

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[1] Justices Stevens and Ginsburg dissented in part on the issue whether the Supreme Court in the first instance should have construed the content of Delaware preclusion law.

supplied). App. 103a. "Indeed, Delaware counsel's representation . . . surpassed inadequacy and sank to a *level of subversion*" (emphasis supplied).[2] App. 93a. In dissent, Judge O'Scannlain made no effort to defend the conduct of class counsel in Delaware. The situation suggested: ". . . dare I say, *collusive* conduct of the Delaware class attorneys" (emphasis in the original). App. 111a. But, he said, "regrettably" (App. 105a), the Delaware court had resolved the issue, and its resolution barred any further inquiry.

4. *Esptein III*. Two days after *Epstein II* was filed, Judge Norris resigned from the Ninth Circuit. Respondents moved for rehearing, Judge Sidney Thomas was assigned to the panel, rehearing was granted, and the prior opinion was withdrawn on the votes of Judges O'Scannlain and Wiggins. App. 117a-136a. Both judges, in different ways, believed that in *Matsushita*, despite footnote 5 (App. 37a), this Court *implicitly* directed them to enforce the Delaware judgment. Judge Thomas dissented.

Judge Wiggins' concurrence emphasized that, while Judge Norris had "convincingly" shown the existence of

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[2] To obtain approval, among other failures, plaintiffs' Delaware counsel: (a) failed to disclose to the Court that the petitioners had asserted claims respecting a $21 million payment to MCA's President, allegedly to induce him to tender his MCA shares -- a claim the Ninth Circuit later calculated had a $1.4 billion value ($17.80 times 78 million shares); (b) falsely represented that there was virtually no chance a class would be certified by the Ninth Circuit. In fact, the Ninth Circuit later certified the class and commended petitioners' counsel's conduct as exemplary; and (c) represented that the weight of the law was against implying a private right of action without disclosing that the Second and Third Circuits had upheld such standing under SEC Rule 14d-10 and no Circuit Court had ever ruled otherwise. The Ninth Circuit later joined these circuits in finding the existence of a private right of action for petitioners' claim.

"hostile" representation by Delaware class counsel (App. 134a), he now believed that this Court had sent "unmistakable signals" that "the Delaware courts likely had already conclusively resolved the due process issue." App. 135a. He concluded that this resolution must be given full faith and credit in federal court "irrespective of whether we agree with that determination." App. 136a.

Judge Thomas's dissent (App. 136a-146a) said that "the actual representation provided by Delaware class counsel was inadequate for the reasons persuasively detailed in Judge Norris's opinion on remand." App. 141a. This conclusion encompassed the determination that Delaware counsel had given the Delaware courts a "misleading and incorrect" analysis of the federal litigation claims. App. 141a. But he also focused upon the purported Delaware class representatives. *There was, he noted, no "record evidence that the class representatives were even members of the putative class."* App. 141a (emphasis added). Moreover, even if they were, at "the time settlement occurred, the statute of limitations prevented the Delaware class from litigating the federal claims in any court." App. 139a. Such class representatives "had absolutely no incentive to obtain fair valuation of the federal claims, because of their inability to assert the claims." App. 140a. The panel's holding, he said, constituted a "license to those who would run to a favorable and remote state court to obtain settlements premised on bargain-basement valuations of federal claims, even when those claims clearly predominate over potential state causes of action." App. 146a.

Finally, and of particular significance to this petition, Judge Thomas recognized that "representational adequacy or adherence to procedural due process" cannot be established by circumstantial evidence. App. 142a.

E. The Motion to Vacate and Delaware Supreme Court Proceedings

1. On December 13, 1999, within four weeks of the United States Supreme Court's denial of *certiorari*, petitioners filed motions and a supporting brief pursuant to Court of Chancery Rules 24 and 60(b) to intervene in this action and vacate the judgment. On August 4, 2000, the court issued an Opinion and a subsequently amended Order denying the motions without an evidentiary hearing.

2. The Supreme Court of Delaware affirmed the decision below. The Delaware Supreme Court acknowledged that the objectors "did not litigate the adequacy of their representation", and that the vice chancellor "did not make an explicit determination, based upon any record evidence, that the plaintiffs were adequate representatives of the class." App. 19a. Nevertheless, the court determined that "there were no findings by the trial court from which it could be inferred that the plaintiffs were inadequate representatives." App. 19a-20a. Of course not. There was no record of any kind! And the court simply had dispensed with the requirement that plaintiffs in a class action affirmatively establish both standing and adequate representation, finding that the requirement was met by the chancellor's determination that the class plaintiffs had not colluded with the defendants to obtain a settlement and by the right of class members to opt out:

> *Implicit in this finding is a consideration of the adequacy of the representation by the class plaintiffs.* To allay any concern on the issue, the Vice Chancellor required an opt out provision in order to protect the interests of any member of the class who had reservations about having their federal claims compromised through the efforts of the class plaintiffs. [Emphasis added]

App. 21a. The court further attempted to bridge the gap between the absence of any record evidence of standing or adequacy, and the need to satisfy adequacy by relying upon the "experience" of the court ("experienced jurist" -- App. 24a) and of class counsel:

> [C]ourt-appointed counsel for the plaintiffs included two of the most experienced shareholder litigation firms in the nation. Those attorneys conducted extensive pretrial discovery and their own analysis of the governing law, permitting them to evaluate the merits of both the Delaware and the federal claims. Moreover, the Court of Chancery's holding that there was no collusion is the equivalent of saying that the parties negotiated the settlement at arms length. [Citations omitted]

App. 20a.

REASONS FOR GRANTING THE WRIT

This petition raises issues of wide importance regarding the extent to which class or other representative actions can be utilized to bind absent parties, in class or other representational processes, to *in personam* judgments. Henceforth, in representational proceedings courts may bind absent parties without any record evidence concerning the representatives' standing or adequacy.

Class action judgments that seek to bind absent class members are an exception to the general rule that one not be bound by a judgment *in personam* to which he or she is not a party. Absent litigants in a class action suit may be bound by the judgment if "they are in fact adequately represented" by parties who are present. *Hansberry v. Lee*, 311 U.S. 32, 42-43 (1940). The class representatives "must possess the same interest and suffer the same injury shared by all members of the class he represents". *Schlesinger v. Reservists Committee to Stop the War*, 418 U.S. 208 (1974). Unquestionably, that alignment was not present here. As Judge Thomas recognized in his dissent in the Ninth Circuit:

> The interests of the Epstein plaintiffs in advancing the federal claims were directly antagonistic to those of the Delaware class representatives.

App. 139a.

Moreover, it is beyond dispute, even in Delaware's highest court, that there was "no record evidence that the class representatives were even members of the putative class. A non-waivable prerequisite to approval of a class settlement binding absent class members is that the class representative be

a member of the class. *See East Texas Motor Freight System, Inc. v. Rodriguez*, 431 U.S. 395, 403 (1977)." App. 141a.

The Delaware Supreme Court dispensed with both the standing and adequacy of representation requirements. In so doing, the Court was misguided about important governing legal principles. *Koon v. United States*, 518 U.S. 81, 100 (1996).

The Delaware Supreme Court arrived at its decision without *any* record evidence that any Delaware plaintiff had standing to prosecute even the local claims, much less that any of these persons satisfied adequacy tests. In their stead, held the Court, both standing and adequacy may be inferred so long as the jurist and class counsel are "experienced".[3] App. 20a, 24a. The Delaware court moreover assigned this crucial role to

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[3] Experienced? This Court may take judicial notice of the fact that the news media has reported that class counsel for the plaintiffs in the Delaware action is the subject of a federal grand jury investigation into whether that law firm "fabricate[d] shareholders". Joyzelle Davis, *Bloomberg News*, "Milberg Weiss Faces U.S. Grand Jury Investigation", Jan. 24, 2002. *See The Washington Post v. Robinson*, 935 F.2d 282, 291 (D.C. Cir. 1991) (allowing judicial notice of existence of news articles publicizing a criminal investigation). In addition, there are numerous instances where counsel's "experience" has included material misinformation concerning their plaintiff's claims or otherwise abused the class action process. *See, e.g., In re Bankamerica Corp. Securities Litigation*, 95 F. Supp.2d 1044, 1050 (E.D.Mo. 2000), *aff'd*, 273 F.3d 795 (8th Cir. 2001) (counsel withdrew one lead plaintiff, a convicted felon, and withdrew the remaining two because they did not purchase shares of stock during the class period, the court concluded its "behavior in these cases are precisely the sort of lawyer-driven machinations the PSLRA was designed to prevent" and its "state case was nothing more than a thinly-veiled attempt to circumvent federal law"); *Comdisco Securities Litigation*, 141 F. Supp.2d 951, 954 (N.D.Ill. 2001) (citing law firm's involvement in dispute surrounding abuses in connection with class action activities in *Lexecon, Inc. v. Milberg Weiss et al.*, adverse jury verdict for abuse of process "ultimately settled . . . by a $55 million payment" to Lexecon, Inc.)

class counsel while acknowledging that it had an inherent conflict of interest. In addition, the Delaware Supreme Court's holding (App. 21a) that class members' right to opt-out can substitute for the requirement of adequacy of representation conflicts with the precedents of this Court and the Delaware Supreme Court itself. *See* concurrence of Justice Ginsburg in *Matsushita v. Epstein*, 516 U.S. 367, 397 (1996) ("[t]he Delaware Supreme Court underscored that due process demands more than notice and an opportunity to opt-out; adequate representation, too, that court emphasized, is an essential ingredient," citing *Prezant v. DeAngelis*, 636 A.2d 915, 924 (Del. 1994) and *Shutts*, *supra*, 472 U.S. at 812). And, as Judge Thomas recognized in his dissent in *Epstein III*, adequacy of representation and procedural due process cannot be established by circumstantial evidence. App. 141a-142a.

Worth perhaps about a penny per share, the Delaware judgment is being used to destroy a federal class action valued with interest at in excess of $20 per share, an aggregate of more than $2 billion. The evils of this startling and unprecedented notion that a concededly conflicted counsel's "experience" can substitute for a record need not be identified in prospect. They are animated in these proceedings. Only this Court's intervention can provide redemption and prevent their occurrence elsewhere.

I. The Decision Conflicts with this Court's Precedents And Underlying Constitutional Provision.

The Delaware Supreme Court substituted its own diminished standard for finding standing and adequacy of representation in this case. According to that court, a lower court may "implicitly" consider the adequacy of representation by the class plaintiffs, and do so without record evidence of

adequacy of representation. App. 21a. The court said nothing about a lack of record evidence regarding standing.

According to the Delaware Supreme Court "experience" of plaintiffs' class counsel and of the court provided record enough. App. 20a, 24a. Moreover, according to the Delaware Supreme Court, the class plaintiffs bear no burden of demonstrating adequacy. Rather, defendants or members of the class must come forward to assert inadequate representation. Finally, the Delaware Supreme Court held that affording class members an opportunity to opt out of the settlement allays adequacy concerns. App. 21a.

The ruling of the Delaware Supreme Court is at odds with the Constitution and decades of precedent in this Court. Since *Hansberry v. Lee*, 311 U.S. 32, 43 (1940), it has been clear that absent class members are bound only if "they are *in fact adequately* represented" (emphasis added). This is "familiar doctrine." Id. at 42-43. *See also Richards v. Jefferson County, Alabama*, 517 U.S. 793, 800-801 (1996), quoting from *Hansberry*. Adequate representation must exist "at all times." *Shutts*, 472 U.S. at 812. *See also Ortiz v. Fibreboard Corp.*, 527 U.S. 815, n.24 (1999) (quoting *Shutts* "at all times" language). As Justice Ginsburg said (App. 55a), *Shutts's* phrase "at all times" means that "the class representative's duty to represent absent class members adequately is a continuing one." From *Hansberry* through *Ortiz*, an invariable theme runs through this Court's cases: If absent members are to be bound on the basis of representation, the class representatives (plaintiffs *and* counsel) must *in fact* be and act as faithful champions of the interests of class.

A judgment that violates due process is not entitled to full faith and credit in "other state and federal courts." *Kremer v. Chemical Construction Corp.*, 456 U.S. 461, 482 (1982)

(App. 47a) (Ginsburg, J.). As shown below, the Delaware procedures were "fundamentally flawed." 456 U.S. at 480.

A. No Record Evidence of Standing or of Adequacy

The Delaware court approved a class settlement without making any inquiry into standing and adequacy of representation. There was no record evidence of any kind that, when they sought certification as class representatives, the putative Delaware class representatives were members of the putative class, or that they held any claims when they sought certification as class representatives that were not barred by the statute of limitations, as Judge Thomas observed (App. 139a, 141a-142a). The court cannot "imply" standing or adequacy of representation. App. 20a-21a. The court must find that class members are, "in fact," adequately represented.

The court's inference was underpinned by its reliance upon the "experience" of the court (App. 24a) and of counsel. App. 20a. This is astounding given the Ninth Circuit's uniform view of class counsel's conduct in Delaware. For example:

> Adequate representation requires that counsel "vigorously and tenaciously protect[ ] the interests of the class." *Gonzales,* 474 F.2d at 75. "Vigorous" and "tenacious" protection requires, at a minimum, that counsel pursue their clients' claims, make a reasonable effort to assess the fair settlement value of those claims, and pursue a settlement that approximates that value, always taking into account the ever-present risks of litigation. The inadequacy of Delaware counsel's representation is brought into sharp focus by their vigorous *disparagement* of the federal claims throughout

> the course of the settlement proceedings. Indeed, Delaware counsel's representation of those claims surpassed inadequacy and sank to the level of subversion.

App. 93a. *See also*, App. 111a (O'Scannlian, J., dissenting) ("dare I say, collusive, conduct of the Delaware Class attorneys"), App. 134a (Wiggins, J. concurring) (recognizing that the opinion in *Epstein II* "convincingly concluded that Delaware counsel provided inadequate representation").

B. Opt-Out Right Cannot Substitute For Adequacy of Representation

The Delaware Supreme Court held that class members' opt-out rights serve as a means of supplementing adequacy of representation:

> To allay any concern on the issue [of adequacy of representation], the Vice Chancellor required an opt out provision in order to protect the interests of any member of the class who had reservations about having their federal claims compromised through the efforts of the class plaintiffs. Significantly, the Epstein plaintiffs did not seek to opt out.

App. 21a. But the right to opt out is *in addition* to the requirement that the class be adequately represented in a class action (App. 57a) (Ginsburg, J.):

> The Delaware Supreme Court underscored [in *Prezant*] that due process demands more than notice and an opportunity to opt-out; adequate

> representation, too, that court emphasized, is an essential ingredient.

This must be especially so here, where the notice to the class regarding the settlement hearing "did not indicate that the issue of adequacy of representation, either by class representative or by class counsel, would be addressed." App. 143a (Thomas, J., dissenting).

CONCLUSION

The petition for a writ of certiorari should be granted, and the judgment of the Delaware Supreme Court vacated.

Dated: February 13, 2002

Respectfully submitted,

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APPENDIX

Supreme Court of Delaware.
In re MCA, INC., Shareholder Litigation, Lawrence Epstein and John
Linder, Petitioners Below, Appellants,
v.
MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD., Matsushita Holding Corp., MCA, Inc.,
Lew W. Wasserman, Thomas V. § Jones, Robert S. Strauss, Thomas Wertheimer,
Howard H. Baker, Jr., Thomas P. Pollack, Felix G. Rohatyn, Sidney J. Sheinberg,
Howard P. Allen, Mary Gardiner Jones, and Charles S. Paul, Defendants Below,
Appellees,
and
Seymour Lazar, A.J. Lou, Marion Lord, Sheldon Shore, Harry Osgood, Barnett
Stepak, Julius Ostreicher, Thomas E. Acito, Darren Suprina, Sara Naphtali,
Stephania Ziemak, Kenneth Pogrob, Elriede Glancy, Jacob Gottlieb and C.
Christopher Muth as Trustee for The Carl H. Muth Trust, Plaintiffs Below,
Appellees.

No. 448, 2000.

Submitted: July 24, 2001.
Decided: Nov. 16, 2001.

Before: WALSH, HOLLAND, BERGER and STEELE, Justices, and RIDGELY, President Judge.

WALSH, J. This is an appeal from a decision of the Court of Chancery which rejected efforts to vacate a 1993 judgment of

that court approving a global settlement of claims arising out of the acquisition of MCA, Inc. and Matsushita Electric Industrial Company. The appellants, original plaintiffs in one aspect of the multi-faceted litigation which the merger spawned, contend the Court of Chancery erred in viewing their attempt at intervention as untimely and in rejecting their claims that the judgment approving the settlement was procured by fraud.

While we conclude that the appellants' status as original parties to the litigation does not require them to assert a timely intervention, we find no abuse of discretion in the Court of Chancery's determination that the settlement judgment was not procured by fraud or void for a specific determination of adequacy of representation. Accordingly, we affirm.

I

The background of this litigation is extensive and is set forth in decisions of the Court of Chancery, this Court, the 9th Circuit Court of Appeals and the United States Supreme Court.[1] We recite only the facts pertinent to an understanding of the present appeal.

On September 25, 1990, *The Wall Street Journal* reported that Matsushita Electric Industrial Company ("Matsushita"), was negotiating a potential acquisition of MCA, Inc. ("MCA"). The

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[1] *In re MCA, Inc., Shareholders Litig.*, Del.Ch., 598 A.2d 687 (1991) (*MCA I*); *In Re MCA, Inc., Shareholders Litig.*, Del.Ch., 1993 WL 43024 (Feb. 16, 1993) (*MCA II*); *aff'd*, Del.Supr., 633 A.2d 370 (1993); *Epstein v. MCA, Inc.*, 9th Cir., 50 F.3d 644 (1995) (*Epstein I*), rev'd, *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 116 S.Ct. 873, 134 L.Ed.2d 6 (1996); *Epstein v. MCA, Inc.*, 9th Cir., 126 F.3d 1235 (1997) (*Epstein II*), withdrawn and superseded on rehearing by *Epstein v. MCA, Inc.*, 9th Cir., 179 F.3d 641 (1999) (*Epstein III*), *cert. denied* 528 U.S. 1004, 120 S.Ct. 497, 145 L.Ed.2d 384 (1999); *In re MCA, Inc. Shareholders Litig.*, Del.Ch., 774 A.2d 272 (2000).

following day three class action complaints were filed in the Court of Chancery. These three actions, styled as individual and class actions, were consolidated for all purposes by then Vice Chancellor Hartnett on October 2, 1990 (the "Delaware Action"). The Complaints alleged, *inter alia*, that the proposed sale of MCA to Matsushita violated the fiduciary duties of the directors of MCA. Specifically, it was alleged that the board violated its *Revlon* duties by not initiating an auction process to maximize shareholder value in a cash sale of the company. The Complaints further alleged that the defendant directors of MCA violated their duties under *Revlon* by wrongfully using a poison pill to thwart other potential bidders.

On November 26, 1990, MCA and Matsushita announced that they had entered into an agreement and plan of merger (the "Merger Agreement"). The Merger Agreement provided that Matsushita Acquisition Corporation ("Matsushita Acquisition") would make a tender offer for all of the outstanding shares of MCA common stock at $66 per share (the "Tender Offer"). Matsushita Acquisition was to merge with and into MCA following successful completion of the Tender Offer. MCA and Pinelands, Inc., ("Pinelands"), a subsidiary of MCA that held its broadcasting rights, entered into a separate agreement pursuant to which 100% of those broadcasting rights would be spun off to MCA shareholders. This transaction was estimated to provide $5 per share additional value to MCA's shareholders.

MCA's Chairman of the Board and Chief Executive Officer, Lew Wasserman ("Wasserman"), was the owner of 4,953,927 MCA shares worth $351,728,817 at the tender price. To avoid a massive tax liability, Wasserman and Matsushita entered into a separate Capital Contribution and Loan Agreement (the "Contribution Agreement") to exchange his MCA shares for preferred stock in a Matsushita subsidiary, MEA Holdings. This preferred stock paid an 8.75% annual cumulative dividend, was secured by letters of credit, and was redeemable at the

tender price upon the death of either Wasserman or his wife. The exchange was set to take place immediately following the time at which shares of MCA were accepted for payment pursuant to the Tender Offer.

MCA also entered into other agreements with MCA's President and Chief Operating Officer, Sidney J. Sheinberg ("Sheinberg"), and record producer David Geffen, MCA's largest individual shareholder. Sheinberg owned 1,179,635 shares of MCA stock that he tendered into Matsushita's Tender Offer. Two days after tendering his shares, Sheinberg received an additional $21 million in cash, which has been attacked as a covert premium designed to induce Sheinberg to tender his shares.

On December 3, 1990, an action was filed in the United States District Court for the Central District of California (the "District Court") designated as *Epstein v. MCA, Inc. et al.*, No. CV-90-6451-R (the "federal action"). Four additional purported class actions alleging similar claims were also filed in the District Court and were consolidated by the District Court on April 1, 1991. The consolidated complaint alleged that the Matsushita Tender Offer violated Section 14(d)(7) of the Securities and Exchange Act of 1934 and SEC Rules 14d-19 and 10b-13 by offering preferential treatment in the Tender Offer to Wasserman and Sheinberg. These claims had not been asserted in the complaints filed in the Delaware Action.

On December 14, 1990, plaintiffs in the Delaware Action filed an amended complaint seeking preliminary injunctive relief against consummation of the Tender Offer. The plaintiffs alleged in the amended complaint that the Tender Offer materials failed to disclose the preferential treatment allegedly given to Wasserman. Moreover, the amended complaint challenged the Sheinberg transaction as violative of Delaware law. Finally, the amended complaint named Matsushita as a

defendant, alleging that Matsushita aided and abetted MCA in a breach of fiduciary duty by entering into the transaction with Wasserman. A preliminary injunction hearing was scheduled for December 18, 1990.

On December 18, 1990, the Delaware Action was provisionally certified as a class action[2] by the Court of Chancery pursuant to Rule 23(b)(2) with the class to consist of all owners of MCA common stock on September 25, 1990. That same day, the parties in the Delaware Action filed a Stipulation and Agreement of Compromise and Settlement (the "Initial Proposed Settlement"). The Initial Proposed Settlement provided for the dismissal of the Delaware Action and the release of all claims of any member of the class arising out of the Merger, including the claims raised in the federal action, in exchange for the payment of attorneys' fees and the modification of a "poison pill"[3] in the charter of the Pinelands subsidiary. A notice of the Initial Proposed Settlement was sent to all MCA shareholders who were members of the class. Andrew and David Minton, (the "Mintons") entered their appearance as objectors at the settlement hearing. The Mintons objected to the Initial Proposed Settlement in so far as it barred individual federal actions filed by them in the District Court.

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[2] The Court of Chancery order recited a certification for settlement purposes only.

[3] The modification provided that the "poison pill" would be automatically redeemable upon the receipt of an all cash, fully financed tender offer for all of the shares of Pinelands that is held open for 60 days and that has at least two-thirds of all outstanding shares tender into the offer. Apparently, this was done to make Pinelands a more attractive acquisition target and potentially provide more value to the MCA shareholders who received the Pinelands stock dividend. The altered pill was required to remain in effect for only one year.

On December 29, 1990, the Tender Offer was completed. More than 90% of all the outstanding shares were tendered in response to Matsushita's offer. Immediately following the Tender Offer, the Capital Contribution Agreement was consummated when Wasserman exchanged his MCA common stock for preferred stock in MEA Holdings. On January 3, 1991, Matsushita acquired MCA for $6.1 billion.

On April 22, 1991, the Court of Chancery rejected the Initial Proposed Settlement as inadequate. *See In re MCA, Inc. Shareholders Litig.*, Del.Ch., 598 A.2d 687, 696 (1991) ("*MCA I*"). The court first ruled that certification of the class pursuant to Chancery Rule 23(b)(1) and (2) was appropriate and that no opportunity to opt out was required because the claims originally sought equitable relief when filed. *See id.* at 692. Regarding the terms of the Initial Proposed Settlement, the court found that the state law claims asserted in the amended complaint were "at best, extremely weak."[4] *Id.* at 694. The court did conclude that the federal securities law claims had at least "arguable merit" since they had not yet been definitively addressed by the District Court. *Id.* at 695. Furthermore, the court found that "[t]he value to the Class from the Pinelands revised poison pill is therefore illusionary and the revision apparently was proposed merely to justify a settlement which offers no real monetary benefit to the Class." *Id.* at 696. Because the benefits to the class were minimal, the court determined that it would "be unfair to compel the release of the federal claims by approving the settlement in its present form," which did not provide class members with the opportunity to opt out. *Id.* at 696.

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[4] Despite this characterization, Matsushita did not move thereafter to dismiss the action.

On April 1, 1991, the District Court rejected the plaintiffs' motion for class certification in the federal action. A second motion for class certification was rejected on September 3, 1991. On August 13, 1991, the District Court dismissed the SEC Rule 10b-13 claims because it concluded that there was no private right of action under that provision. Thereafter, on February 10, 1992, Matsushita was awarded summary judgment on all counts. The District Court concluded that the Wasserman transaction did not take place within the Tender Offer period and that Wasserman did not receive a greater consideration than other shareholders. Following this decision, the Epstein plaintiffs filed an appeal to the Ninth Circuit Court of Appeals challenging the district court's grant of summary judgment, as well as prior decisions denying class certification and finding the Epstein plaintiffs and counsel in contempt of a discovery order.

On October 22, 1992, the parties in the Delaware Action filed the second stipulation of global settlement releasing the federal and state claims (the "Settlement") for $2 million, less $575,000 in fees and expenses sought by class counsel. The Settlement consideration for the class amounted to approximately two to three cents per share and provided the class members with opt out rights. Three members of the class objected to the proposed settlement.[5] Vice Chancellor Hartnett concluded that the $2 million recovery was "barely" adequate to support the Settlement. *See In re MCA, Inc., Shareholders Litig.*, Del.Ch., 1993 WL 43024 at *4 (1993) *reprinted in,* 18 Del.J. Corp. L. 1053 ("*MCA II*"). The court approved the Settlement over the arguments of the objectors, who contended that the plaintiffs in the Delaware Action colluded with MCA and Matsushita to settle the dispute in exchange for a *de minimis* benefit to the

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[5] None of the objectors raised the issue of the adequacy of the class representatives.

class and an award of attorneys' fees. The Court of Chancery noted the District Court's dismissal as an indication that the federal securities law claims were of "minimal" value but that, in any event, "[t]he availability of the right to opt-out of the class protects the ability of class members ..." who wish to continue the federal litigation. *Id.* Indeed, due to concern that some shareholders may not have received timely notice of the Settlement, the Vice Chancellor extended the opt out deadline and requested that the proposed order implementing the opinion be amended to reflect that extension. *See MCA II,* 1993 WL 43024 at *7.

On February 17, 1993, class counsel submitted an amended proposed order and final judgment (the "Amended Order") that extended the opt out deadline. The cover letter accompanying the Amended Order stated that it had been approved by counsel for the settling parties and copies of the Order were sent to all counsel involved, including objectors. The Amended Order also contained a provision that stated: "and it is hereby further determined that the plaintiffs in the Actions, as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class and that the maintenance of the action as a class action meets all the requirements of Rule 23(a) and (b)(3) of the Court of Chancery." The Judgment was signed by the Vice Chancellor on February 22, 1993.

The Minton objectors appealed the Court of Chancery's approval of the Settlement to this Court. In that appeal, the Objectors argued, *inter alia,* that the Settlement should not have been approved because it compromised viable federal securities law claims pending in California. The objectors did not assert any claims with regard to the adequacy of the class representatives. After hearing argument, this Court summarily affirmed the Vice Chancellor's decision approving the Settlement.

On February 24, 1993, Matsushita sought dismissal of the Epstein Action in the Ninth Circuit Court of Appeals based on the terms of the Settlement. The Epstein plaintiffs asserted, however, that the Court of Chancery lacked the authority to approve the release of exclusively federal claims and that therefore the judgment approving the settlement was not binding on parties to the federal action. The Ninth Circuit agreed, concluding that the Delaware judgment was not entitled to full faith and credit. *See Epstein v. MCA, Inc.*, 9th Cir., 50 F.3d 644 (1995) ("*Epstein I*") *rev'd Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 116 S.Ct. 873, 134 L.Ed.2d 6 (1996). The Ninth Circuit reversed the decision of the District Court and vacated the grant of summary judgment in favor of Matsushita on all claims.

Matsushita petitioned for a writ of *certiorari*, which was accepted by the United States Supreme Court as to one question: "whether a federal court may withhold full faith and credit from a state-court judgment approving a class-action settlement simply because the settlement releases claims within the exclusive jurisdiction of the federal courts." *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 369, 116 S.Ct. 873, 134 L.Ed.2d 6 (1996). The Supreme Court reversed, holding that "a federal court must give the judgment the same effect that it would have in the courts of the State in which it was rendered." *Id.* at 369, 116 S.Ct. 873. Accordingly, the Court remanded the matter to the Ninth Circuit.[6]

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[6] Responding to the Epstein plaintiffs' argument that inadequate representation deprived the absent class members of due process of law, an argument that had not been raised in the court below, the Supreme Court responded in a footnote that:

Apart from any discussion of Delaware law, respondents contend that the settlement proceedings did not satisfy due process because the class

(continued...)

On October 22, 1997, a panel of the Ninth Circuit held that the class members had been deprived of due process by inadequate representation at the Delaware Settlement hearing. *See Epstein v. MCA, Inc.*, 9th Cir., 126 F.3d 1235 (1997) ("*Epstein II* "), *withdrawn and superseded on rehearing by Epstein v. MCA, Inc.*, 9th Cir., 179 F.3d 641 (1999). On June 7, 1999, a reconstituted panel of the Ninth Circuit withdrew the *Epstein II* opinion. *See Epstein v. MCA, Inc.*, 9th Cir., 179 F.3d 641 (1999) ("*Epstein III* "). The court ruled that "the Delaware judgment was not constitutionally infirm." *See id.* at 650. On November 15, 1999, the United States Supreme Court denied the Epstein plaintiffs' petition for a writ of *certiorari*.[7]

On December 13, 1999, the Epstein plaintiffs filed a motion in the Court of Chancery seeking to intervene and vacate the

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[6](...continued)
was inadequately represented. Respondents make this claim in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class. *Cf. Prezant v. De Angelis*, 636 A.2d 915, 923 (Del.1994) ("[The] constitutional requirement [of adequacy of representation] is embodied in [Delaware] Rule 23(a)(4), which requires that the named plaintiff 'fairly and adequately protect the interests of the class' "). We need not address the due process claim, however, because it is outside the scope of the question presented in this Court.

Matsushita, 516 U.S. at 379 n. 5, 116 S.Ct. 873 (citations omitted). In a separate opinion, Justice Ginsburg addressed the inadequate representation argument and noted that the question "remain[ed] open for airing on remand." *Id.* at 399 & n. 11, 116 S.Ct. 873 (Ginsburg, J., concurring in part and dissenting in part).

[7] On July 20, 2000, the Ninth Circuit panel issued an Order providing that those MCA shareholders who opted out of the Settlement can proceed to trial against Matsushita.

court's settlement approval order in *MCA II.* Initially, the Court of Chancery denied Petitioners' Motion to Intervene on the ground that it was not timely. *See In re MCA, Inc. Shareholders Litig.*, Del.Ch., 774 A.2d 272, 278 (2000). The court noted that the Petitioners could have appeared and objected to the settlement before it was approved by the court. The Court of Chancery seemed particularly troubled by the fact that Petitioners chose not to participate in the Delaware proceedings, instead asserting in the District Court that they were not bound by the settlement. *See* 774 A.2d at 276 ("Even before that ruling, however, the Epstein petitioners had abjured the courts of Delaware in favor of litigating in federal court."). The court concluded that the Motion to Intervene was untimely because the Epstein Plaintiffs had seven years to appear in Delaware and challenge the Settlement and neglected to do so. *See id.* at 278.

Despite the finding of untimeliness, the Chancellor proceeded to address the remaining claims raised by the Epstein plaintiffs. *See id.* at 278 ("Despite my ruling on the motion to intervene, I will, given the long history of this case, entertain some of the Epstein petitioners' arguments on the merits to resolve a few lingering questions."). Addressing the Epstein plaintiffs' contention that the Judgment approving the Settlement was void "because it denied petitioners and the class due process," the Chancellor ruled that it was beyond doubt that the class was afforded due process. Moreover, the court held that it was bound by the law of the case doctrine, stating that the Delaware Supreme Court "implicitly affirmed, albeit by summary order, Vice Chancellor Hartnett's adequacy determination." *See id.* at 279. The Epstein plaintiffs' final claim alleged that suspicious circumstances and perhaps fraudulent conduct surrounded the entering of the Settlement Order and that the Judgment should be reopened pursuant to Rule 60(b)(3). The Chancellor rejected this claim, holding that the charge of misconduct on the part of

class counsel was "not supported by any credible evidence." *See id.* This appeal followed.

II

Essentially, the Epstein plaintiffs make two major arguments. First, they contend that the judgment in this case is void because there was no finding by the Court of Chancery in approving the Settlement that the named plaintiffs were adequate representatives of the entire class. This deficiency, it is argued, renders the Settlement violative of due process of law and transgresses Court of Chancery Rule 23(a)(4). They further argue that the Chancellor neglected to address this question below. Second, it is contended that the Court of Chancery erred in refusing to grant their motion to vacate the Settlement Judgment for reasons of fraud perpetrated on the court by class counsel.

The class plaintiffs have joined their erstwhile foes, Matsushita and MCA, in resisting the efforts of the Epstein plaintiffs to reopen the settlement judgment. They contend that the Settlement Approval Judgment was entered under terms which afforded the class members due process and that the Chancellor did not abuse his discretion in denying Appellants' motion to reopen that judgment.

A motion to reopen a judgment under Court of Chancery Rule 60(b) is addressed to the sound discretion of the trial court. This Court's review of the grant or denial of such a motion is for an abuse of discretion. *Battaglia v. Wilmington Sav. Fund Soc.*, Del.Supr., 379 A.2d 1132, 1135 (1977); *see also Wife B. v. Husband B.*, Del.Supr., 395 A.2d 358 (1978) (same).[8] "An

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[8] The Epstein plaintiffs contend that this Court should review the (continued...)

abuse of discretion occurs when 'a court has ... exceeded the bounds of reason in view of the circumstances, [or] ... so ignored recognized rules of law or practice so as to produce injustice.' " *Lilly v. State,* Del.Supr., 649 A.2d 1055, 1059 (1994) (quoting *Firestone Tire & Rubber Co. v. Adams,* Del.Supr., 541 A.2d 567, 570 (1988)).

On appeal from the grant or denial of a motion for relief under Rule 60(b) a party may attack only the propriety of the order; Rule 60(b) "does not permit the appellant to attack the underlying judgment for an error which he could have complained of on appeal from it." *Swann v. Carey,* Del.Supr., 272 A.2d 711, 712 (1970).

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[8](...continued)
Chancellor's dismissal of their Rule 60(b)(4) motion *de novo* on the basis that whether a judgment is void is a question of law. For support, the Epstein plaintiffs cite *State v. Moore,* Del.Super., No. N91-07- 1485M, 1992 WL 354194, Cooch, J. (Nov. 6, 1992), where the Superior Court granted the defendant's motion under Rule 60(b)(4) and vacated an order declaring the defendant an habitual offender because it found that service was not proper. The court stated that it had "no discretion under ... Rule 60(b)(4) to decline to vacate a void order, because a void order is legally ineffective from its inception." *See* 11 Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, Federal Practice and Procedure § 2862 (1995) (hereinafter "Wright & Miller") ("There is no question of discretion on the part of the court when a motion is under 60(b)(4) .... [e]ither a judgment is void or it is valid. Determining which it is may well present a difficult question, but when that question is resolved, the court must act accordingly."). The basis for the Epstein plaintiffs' claim that the judgment is void, however, is that Vice Chancellor Hartnett's finding of adequate representation was not supported by the record. That assertion, when subsequently addressed by the Chancellor, required the court to examine the conduct of the parties, as well as the perceived intention of the court entering the judgment, a weighing process that necessarily requires deference from a reviewing court.

Court of Chancery Rule 60(b) permits a party to seek relief from a final judgment or order. Rule 60(b) provides, in part, that:

> On motion and upon such terms as are just, the Court may relieve a party ... from a final judgment, order, or proceeding for the following reasons: (1) Mistake, inadvertence, surprise, or excusable neglect; (2) newly discovered evidence; (3) fraud (whether heretofore denominated intrinsic or extrinsic), misrepresentation or other misconduct of an adverse party; (4) the judgment is void; (5) the judgment has been satisfied, released, or discharged, or a prior judgment upon which it is based has been reversed or otherwise vacated, or it is no longer equitable that the judgment should have prospective application; or (6) any other reason justifying relief from the operation of the judgment.

Ch.Ct.R. 60(b). In addition, a trial court has the power "to set aside a judgment for fraud upon the Court." *See id.* A court does not have to wait for a party to make a motion for relief under this section; rather a court may take independent action to relieve a party from a judgment pursuant to this rule. *See id.*

There are two significant values implicated by Rule 60(b). The first is ensuring the integrity of the judicial process and the second, countervailing, consideration is the finality of judgments.[9] *See Credit Lyonnais Bank Nederland, N.V. v.*

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[9] Counsel for the Class plaintiffs contend that in order to succeed on a Rule 60(b) motion the moving party must show "extraordinary

(continued...)

Pathe Communications Corp., Del.Ch., 1996 WL 757274 at *1, Allen, C. (Dec. 20, 1996). Because of the significant interest in preserving the finality of judgments, Rule 60(b) motions are not to be taken lightly or easily granted.[10] A proper standard must strike a balance between the interest in bringing litigation to an end and the countervailing concern that justice is carried out. *See* Wright & Miller, § 2851.

III

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[9](...continued)
circumstances" require reopening or vacating the judgment. Such a showing is only required, however, where a party makes a motion under Rule 60(b)(6), the catchall provision of Rule 60(b). *See, e.g., Dixon v. Delaware Olds, Inc.*, Del.Supr., 405 A.2d 117, 119 (1979) ("Federal case law under Rule 60(b) of the Federal Rules of Civil Procedure holds that the standard or test for granting a(b)(6) motion is a showing of 'extraordinary situation or circumstances'."). The standard required to succeed under other sections of Rule 60(b) is not as exacting. *See* Wright & Miller, § 2857 ("the leading cases speaking of a requirement of exceptional or extraordinary circumstances have been cases of motions under 60(b)(6). That subdivision of the rule does require a very special showing by the moving party and it does not assist sound analysis to repeat those phrases in cases brought pursuant to the other portions of Rule 60(b), under which a less demanding standard applies. Although 'extraordinary circumstances' should only be required under catchall clause (6) of the rule, some courts have erroneously restricted relief under other provisions of the rule by reading that requirement into earlier clauses") (citations omitted).

[10] See, e.g., *Metlyn Realty Corp. v. Esmark, Inc.*, 7th Cir., 763 F.2d 826, 830 (1985), where the Seventh Circuit stated that:
Judgments in civil cases fix the rights of parties and entitle them to go about their lives. They may be reopened only for extraordinary reasons.... There are good reasons for the stringent limits on reopening a final judgment.... If they know that the judgment will establish their rights once and for all, they will bring to bear the information and energies necessary to produce an informed decision. If they believe that they can have a second try, they are more likely to skimp the first time around, and as a result the judicial process will become less accurate.

Our task, then, is to determine whether the Chancellor abused his discretion in denying the Epstein plaintiffs' motion to vacate the Judgment pursuant to Rule 60(b)(4). The Epstein plaintiffs contend that the Judgment is void because the record does not support a finding that the class was adequately represented. The Chancellor held that then Vice Chancellor Hartnett addressed the adequacy of representation issue when he considered the Objectors' collusion argument. *See MCA,* 774 A.2d at 278. In addition, the Chancellor found that he was bound by the law of the case doctrine as to the adequacy issue because this Court affirmed the Vice Chancellor's approval of the Settlement.

Court of Chancery Rule 23(a) sets out four requirements that must be met in order for a representative party to maintain an action on behalf of an entire class.[11] Pursuant to Court of Chancery Rule 23(a)(4), it must be demonstrated that the "representative parties will fairly and adequately protect the interests of the class." Ct.Ch.R. 23(a)(4). This requirement is more than a procedural technicality. Indeed, this requisite has constitutional dimensions rooted in the Due Process Clause of the United States Constitution. *See Phillips Petroleum Co. v. Shutts,* 472 U.S. 797, 812, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985) (stating that the Due Process Clause requires "that the named plaintiff at all times adequately represent the interests of the absent class members"). In addition to adequate representation, absent class members must be afforded notice,

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[11] Rule 23(a) provides that:

One or more members of a class may sue ... as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

Ct.Ch.R. 23(a).

an opportunity to be heard, and a right to opt out in order to be bound by a settlement. *Shutts*, 472 U.S. at 812, 105 S.Ct. 2965. This is necessary to ensure that the interests of individuals who are not directly participating in the action, but who may be bound by the outcome, are sufficiently protected. If the principles of due process are not followed, members of the class cannot be bound by a judgment or settlement. *See Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 388, 116 S.Ct. 873, 134 L.Ed.2d 6 (1996) (Ginsburg, J., concurring in part dissenting in part) ("In the class action setting, adequate representation is among the due process ingredients that must be supplied if the judgment is to bind absent class members.") (citing *Phillips Petroleum Co. v. Shutts*, 472 U.S. at 812, 105 S.Ct. 2965; *Prezant v. De Angelis*, Del.Supr., 636 A.2d 915, 923-924 (1994)).

In *Prezant v. De Angelis*, Del.Supr., 636 A.2d 915, 924 (1994), a case decided after the Settlement was approved in the present case, this Court considered whether adequate class representation was an indispensable requisite for approval of a class action settlement. This Court concluded that it was, stating that "[d]ue process requires ... adequate representation before an absent class member can be bound by a settlement in a class action predominately for money damages." *See id.* at 924 (citing *Shutts*, 472 U.S. at 812, 105 S.Ct. 2965). Because of the constitutional implications regarding adequate representation, we determined that a finding of adequacy must be made by the trial court, on the record, before absent class members could be bound by a settlement. *See id.* (stating that "when claims of absent class members are being compromised, the appropriate course is for the Court of Chancery to make an explicit finding on the record that the action satisfies the criteria of Rule 23 and is thus properly maintainable as a class action"). This Court rejected the argument that approval of a settlement "carries with it an implicit determination that the action complies with the Rule 23 criteria, including adequate

representation." *Id.* at 924. Rather, we held that the Court of Chancery is required to make an explicit finding, on the record, that the criteria for maintaining a class action have been met. *See id.* at 925. Indeed, this Court stated that "a class action settlement could not constitutionally bind absent class members without a judicial determination that the adequate representation requirement of Rule 23(a)(4) has been satisfied." *See id.* at 924.

Prezant, however, did not directly apply at the time of the Settlement in this case. While *Prezant* determined the proper approach to be taken where a class action suit is being settled, its direction of explicit findings was not binding on the Court of Chancery at the time the Settlement was approved in this case. Therefore, when the Second Settlement was approved by the Vice Chancellor there was no requirement that a specific finding of adequacy be made on the record. The due process concerns embraced by this Court's decision in *Prezant,* however, were applicable at the time the Vice Chancellor approved the Settlement in this case.

The Epstein plaintiffs contend that the Court of Chancery failed to address their contention that the record did not support a finding that the named plaintiffs fairly and adequately protected the interests of the class, a finding required by *Prezant.* It is true that the Chancellor did not expressly address this argument. The Chancellor did determine, however, that the class was appropriately afforded due process. *See MCA III,* 774 A.2d at 278. In considering the Epstein plaintiffs' argument that the Judgment was void under Rule 60(b)(4) because there was no specific finding of adequacy on the record, the Chancellor found that "The Court specifically addressed (and rejected) the objectors' collusion argument--which went to the heart of the adequate representation issue." *See MCA III,* 774 A.2d at 278. As we indicated above, the Vice Chancellor was not required, pre-*Prezant,* to make an explicit finding of adequate

representation on the record at the Settlement Hearing. Considerations of due process, however, did require recognition by the court of adequate representation by the named plaintiffs.

Unfortunately, the Vice Chancellor did not make an explicit determination, based upon any record evidence, that the plaintiffs were adequate representatives of the class. What he did consider and reject was the argument that plaintiffs and their counsel were in collusion with the defendants. The objectors who appeared at the settlement hearing did not litigate the adequacy of their representation. While two of the objectors argued that the settlement was collusive, neither focused on the much broader issue of whether representation was constitutionally adequate. The only mention of adequacy of representation is found in an affidavit submitted by objector William Krupman stating that he opposed the settlement because "the purported class representatives ... had proposed a settlement that benefitted no one but their own attorneys. They did not provide adequate representation." In his argument at the settlement hearing, however, objector Krupman did not address the constitutional adequacy of the representation, but argued only that the terms of the settlement were unfair. Since the Chancery Court could have found that representation was inadequate without also finding that it was collusive, litigation of the collusion issue would not necessarily constitute litigation of adequacy of representation.

In *Prezant,* this Court rejected defendants' assertion that court approval of a class action settlement carries with it an implicit determination that the action complies with the Rule 23 criteria, including adequate representation. *Id.* at 924. The problem with an implicit determination approach was illustrated by the trial court in *Prezant,* which made specific findings from which it could have been inferred that the plaintiff was an *inadequate* class representative, yet the settlement was approved anyway. *Id.* In the present case, there were no findings by the trial court

from which it could be inferred that the plaintiffs were inadequate representatives. To the contrary, the court rejected the charge that plaintiffs were in collusion with the defendants. Furthermore, court-appointed counsel[12] for the plaintiffs included two of the most experienced shareholder litigation firms in the nation. Those attorneys conducted extensive pretrial discovery and their own analysis of the governing law, permitting them to evaluate the merits of both the Delaware and the federal claims. Moreover, the Court of Chancery's holding that there was no collusion is the equivalent of saying that the parties negotiated the settlement at arms length. *See Prezant,* 636 A.2d at 924 (stressing the need for "extensive document examination, depositions of adverse witnesses, securing expert advice on complicated issues, and aggressive negotiation at arms-length."). Finally, inferring the adequacy of representation from the trial court's finding that the plaintiffs were not in collusion with the defendants is not the same as implying a finding of adequacy from the mere fact that the settlement was approved, as was criticized in *Prezant.*

Discovery had been conducted in this case by class counsel prior to the settlement submission and counsel was knowledgeable of the state and federal claims. In fact, on December 14, 1990, the class plaintiffs filed an amended complaint adding claims for violations of Delaware law arising out of the Wasserman and Sheinberg transactions, which were

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[12] The Court of Chancery has observed that adequacy of representation under Rule 23(a)(4) is generally dependent not only upon the ability of the named representative to represent the class fairly and adequately but also upon the qualifications, experience, and general ability of the representative's attorneys. *See Leon N. Weiner & Assoc. v. Krapf,* Del.Supr., 584 A.2d 1220, 1225 (1991); *Van de Walle v. Salomon Bros.,* Del.Ch., C.A. No. 9894, 1997 WL 633288, Steele, V.C. (Sept. 30, 1997); *Barbieri v. Swing-N-Slide Corp.,* Del.Ch., C.A. No. 14239, 1996 WL 255907, Steele, V.C. (May 7, 1996); *Glosser v. Cellcor,* Del.Ch., C.A. No. 12725, 1995 WL 106527, Allen, C. (Mar. 10, 1995).

the basis for the federal claims. There is no doubt that the Vice Chancellor considered the viability of the federal claims, implicitly considering the adequacy of the class plaintiffs' representation. Moreover, as the Chancellor pointed out below, the Vice Chancellor specifically considered and rejected the argument raised by the Objectors that the class plaintiffs had colluded with the defendants in order to obtain a settlement. Implicit in this finding is a consideration of the adequacy of the representation by the class plaintiffs. To allay any concern on the issue, the Vice Chancellor required an opt out provision in order to protect the interests of any member of the class who had reservations about having their federal claims compromised through the efforts of the class plaintiffs. Significantly, the Epstein plaintiffs did not seek to opt out. The Chancellor's denial of the Epstein plaintiffs' motion to vacate on this ground does not constitute an abuse of discretion.[13]

IV

The Epstein plaintiffs next contend that class counsel procured the Settlement in the Court of Chancery through misrepresentation and fraud. Specifically, the Epstein plaintiffs assert that class counsel misrepresented and concealed material facts concerning the value of the federal claims, and thereby violated their obligation of candor toward the tribunal as well as their fiduciary duty to protect the interests of the class. Furthermore, the Epstein plaintiffs contend that the Court of Chancery applied an incorrect legal standard in ruling on their Rule 60(b)(3) motion alleging fraud.

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[13] A conclusion by this Court that the Chancellor did not abuse his discretion in determining that the Epstein plaintiffs were not entitled to vacate the Judgment as void would obviate the need to address the argument that the adequacy issue is settled by the law of the case.

A Rule 60(b) motion is a "discretionary matter which requires the Trial Judge to weigh the facts and circumstances of [the] case." *Bachtle v. Bachtle,* Del.Supr., 494 A.2d 1253, 1256 (1985). As noted above, the grant or denial of a Rule 60(b) motion is generally reviewed for an abuse of discretion. A claim that the trial court employed an incorrect legal standard, however, raises a question of law that this Court reviews *de novo. Cf. Ison v. E.I. duPont De Nemours & Co., Inc.,* Del.Supr., 729 A.2d 832, 847 (1999) (reviewing *de novo* a claim that the court applied the incorrect legal standard in ruling on a motion to dismiss).

A motion under Rule 60(b)(3) may be granted where it is demonstrated that there was fraud, misrepresentation or other misconduct on the part of an adverse party. Ch.Ct.R. 60(b)(3). The Chancellor found that there was no evidence to support the accusation that class counsel duped the Vice Chancellor into signing the final judgment or order without understanding it or reading it. Reviewing the claim of fraud and misrepresentation, the Chancellor stated that "no evidence whatsoever supports it, let alone evidence capable of meeting the high Rule 60(b) standard, which requires 'the most egregious conduct involving a corruption of the judicial process itself.' " *See id.* at 280 (citing Wright & Miller, § 2870, at 418-19 (1995) (citation omitted)).

A Rule 60(b)(3) motion is reserved for situations where a party has engaged in fraud or misrepresentation that prevents the moving party from fairly and adequately presenting his or her case. *See* Wright & Miller, § 2860. The Epstein plaintiffs do not claim that the alleged fraud on the part of class counsel prevented them from adequately presenting their case.[14] Rather,

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[14] The Epstein plaintiffs, as members of the class, received notice

(continued...)

the Epstein plaintiffs' contention is based on a theory that class counsel committed a fraud upon the court. Rule 60(b) states that it does not limit "the power of a Court ... to set aside a judgment for fraud upon the Court." The Epstein plaintiffs' claim is more properly characterized as a motion pursuant to Rule 60(b) that the judgment of the Vice Chancellor should be set aside because there was a fraud upon the court, rather than a motion under Rule 60(b)(3).[15] So characterized, the Chancellor applied the appropriate standard in ruling on the Epstein's plaintiffs' motion. Therefore, this Court's determination is limited to an inquiry into whether the Chancellor abused his discretion.

The Epstein plaintiffs contend that class counsel, at the Settlement hearing, fraudulently procured the Vice Chancellor's approval of the Settlement by: (i) duping the Vice Chancellor into signing the Amended Order, which contained a statement relating to the adequacy of representation; (ii) misrepresenting the merits of the federal claims; (iii) stating that it was unlikely that the Ninth Circuit would find a private right of standing to enforce SEC Rules 10b-13 and 14d-10; (iv) disparaging the viability of the Wasserman claim; (v) neglecting to mention the Sheinberg claim; and (vi) arguing that damages resulting from the Wasserman claim were highly questionable.

A party seeking to vacate an order on the ground that his or her opponent effectuated a fraud on the court bears a heavy burden. As the Chancellor pointed out, to establish such a claim

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[14](...continued)
of the proposed settlement but declined to participate as objectors or, as noted above, to simply opt out.

[15] Rule 60(b)(3) is generally employed in situations where fraud or misrepresentation between the parties has occurred. *See* Wright & Miller, § 2870.

requires a showing of "the most egregious conduct involving a corruption of the judicial process itself." *See* Wright & Miller, § 2870. The claims put forth by the Epstein plaintiffs do not rise to this level of fraud. It has been recognized that there is an inherent conflict when class counsel seeks to settle claims on behalf of a class whose claims have been asserted globally in different jurisdictions on different grounds. Some of those claims are not as meritorious as others but a global settlement must, of necessity, embrace them all. Class counsel stands to collect a sizable fee from the settlement award and is thus eager to extend the reach of the settlement as far as possible. Courts have recognized the problem inherent in this situation and have established standards to prevent class counsel from selling out the class merely to collect that fee. *See Prezant; Goodrich v. E.F. Hutton Group, Inc.*, Del.Supr., 681 A.2d 1039, 1045 (1996).

While class counsel in this case may have been trying to downplay the potential value of the federal claims in order to achieve a settlement, the record does not reflect that his conduct at the Settlement hearing rises to the level of perpetuating a fraud upon the court. It is true that the Amended Order contained a provision regarding the adequacy of the class representative. The Vice Chancellor, an experienced jurist with extensive familiarity with the intricacies of class and derivative settlements, however, was free to reject that provision prior to signing it. There is certainly no evidence that the provision was added after the Vice Chancellor's signature was obtained, conduct that clearly would rise to the level of fraud on the court. Nor does the record suggest that class counsel made affirmative misrepresentations to the court in an attempt to induce the Vice Chancellor to approve the Settlement. The Vice Chancellor was free to independently review the merits of the federal claims. Moreover, the record reflects that class counsel merely attempted to advance his position that the federal claims were of questionable value, stating for instance

that it was "unlikely that the Ninth Circuit" would find a private right of standing to enforce the SEC Rules at issue. Reasonable minds may differ as to how a court is likely to rule on a given issue, but advocating a tenuous position does not amount to a fraud on the court.

As the Chancellor found, the record does not reflect that class counsel engaged in any conduct constituting a corruption of the judicial process. While class counsel may have been advocating that the federal claims were of marginal value, whether that is true or not, there is no evidence that class counsel committed a fraud upon the court. The Chancellor did not abuse his discretion in denying the motion to vacate.

For the foregoing reasons, we AFFIRM the decision of the Court of Chancery.

Supreme Court of the United States

MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD., et al., Petitioners,

v.

Lawrence EPSTEIN et al.

No. 94-1809.

Argued Nov. 27, 1995.
Decided Feb. 27, 1996.

THOMAS, J., delivered the opinion of the Court, in which REHNQUIST, C.J., and O'CONNOR, SCALIA, KENNEDY, SOUTER, KENNEDY, SOUTER, and BREYER, JJ., joined, in which STEVENS, J., joined as to Parts I, II-A, and II-C, and in which GINSBURG, J., joined in part. STEVENS, J., filed an opinion concurring in part and dissenting in part. GINSBURG, J., filed an opinion concurring in part and dissenting in part, in which STEVENS, J., joined, and in which SOUTER, J., joined as to Part II- B.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Barry R. Ostrager, New York City, for petitioners.

Henry P. Monaghan, New York City, for respondents.

Justice THOMAS delivered the opinion of the Court.

This case presents the question whether a federal court may withhold full faith and credit from a state-court judgment approving a class-action settlement simply because the settlement releases claims within the exclusive jurisdiction of

the federal courts. The answer is no. Absent a partial repeal of the Full Faith and Credit Act, 28 U.S.C. § 1738, by another federal statute, a federal court must give the judgment the same effect that it would have in the courts of the State in which it was rendered.

I

In 1990, petitioner Matsushita Electric Industrial Co. made a tender offer for the common stock of MCA, Inc., a Delaware corporation. The tender offer not only resulted in Matsushita's acquisition of MCA, but also precipitated two lawsuits on behalf of the holders of MCA's common stock. First, a class action was filed in the Delaware Court of Chancery against MCA and its directors for breach of fiduciary duty in failing to maximize shareholder value. The complaint was later amended to state additional claims against MCA's directors for, *inter alia,* waste of corporate assets by exposing MCA to liability under the federal securities laws. In addition, Matsushita was added as a defendant and was accused of conspiring with MCA's directors to violate Delaware law. The Delaware suit was based purely on state-law claims.

While the state class action was pending, the instant suit was filed in Federal District Court in California. The complaint named Matsushita as a defendant and alleged that Matsushita's tender offer violated Securities Exchange Commission (SEC) Rules 10b-3 and 14d-10.[1] These Rules were created by the SEC pursuant to the 1968 Williams Act Amendments to the Securities Exchange Act of 1934 (Exchange Act), 48 Stat. 881, as amended, 15 U.S.C. § 78a *et seq.* Section 27 of the

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[1] We express no opinion in this case on the existence of a private cause of action under § § 14(d)(6) and (7) of the Exchange Act, 15 U.S.C. § § 78n(d)(6) and (7), the statutory authority for Rule 14d-10.

Exchange Act confers exclusive jurisdiction upon the federal courts for suits brought to enforce the Act or rules and regulations promulgated thereunder. See 15 U.S.C. § 78aa. The District Court declined to certify the class, entered summary judgment for Matsushita, and dismissed the case. The plaintiffs appealed to the Court of Appeals for the Ninth Circuit.

After the federal plaintiffs filed their notice of appeal but before the Ninth Circuit handed down a decision, the parties to the Delaware suit negotiated a settlement.[2] In exchange for a global release of all claims arising out of the Matsushita-MCA acquisition, the defendants would deposit $2 million into a settlement fund to be distributed *pro rata* to the members of the class. As required by Delaware Chancery Rule 23, which is modeled on Federal Rule of Civil Procedure 23, the Chancery Court certified the class for purposes of settlement and approved a notice of the proposed settlement. The notice informed the class members of their right to request exclusion from the settlement class and to appear and present argument at a scheduled hearing to determine the fairness of the settlement. In particular, the notice stated that "[b]y filing a valid Request for Exclusion, a member of the Settlement Class will not be precluded by the Settlement from individually seeking to pursue the claims alleged in the ... California Federal Actions, ... or any other claim relating to the events at issue in the Delaware Actions." App. to Pet. for Cert. 96a. Two such notices were mailed to the class members and the notice was also published in the national edition of the Wall Street Journal. The Chancery Court then held a hearing. After argument from

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[2] A previous settlement was rejected by the Court of Chancery as unfair to the class. See *In re MCA, Inc. Shareholders Litigation*, 598 A.2d 687 (1991).

several objectors, the Court found the class representation adequate and the settlement fair.

The order and final judgment of the Chancery Court incorporated the terms of the settlement agreement, providing:

> All claims, rights and causes of action (state or federal, including but not limited to claims arising under the federal securities law, any rules or regulations promulgated thereunder, or otherwise), whether known or unknown that are, could have been or might in the future be asserted by any of the plaintiffs or any member of the Settlement Class *(other than those who have validly requested exclusion therefrom), ...* in connection with or that arise now or hereafter out of the Merger Agreement, the Tender Offer, the Distribution Agreement, the Capital Contribution Agreement, the employee compensation arrangements, the Tender Agreements, the Initial Proposed Settlement, this Settlement ... *and including without limitation the claims asserted in the California Federal Actions* ... are hereby compromised, settled, released and discharged with prejudice by virtue of the proceedings herein and this Order and Final Judgment." *In re MCA, Inc. Shareholders Litigation,* C.A. No. 11740 (Feb. 22, 1993), reprinted in App. to Pet. for Cert. 74a-75a (emphasis added).

The judgment also stated that the notice met all the requirements of due process. The Delaware Supreme Court affirmed. *In re MCA, Inc., Shareholders Litigation,* 633 A.2d 370 (1993) (judgment order).

Respondents were members of both the state and federal plaintiff classes. Following issuance of the notice of proposed settlement of the Delaware litigation, respondents neither opted out of the settlement class nor appeared at the hearing to contest the settlement or the representation of the class. On appeal in the Ninth Circuit, petitioner Matsushita invoked the Delaware judgment as a bar to further prosecution of that action under the Full Faith and Credit Act, 28 U.S.C. § 1738.

The Ninth Circuit rejected petitioner's argument, ruling that § 1738 did not apply. *Epstein v. MCA, Inc.*, 50 F.3d 644, 661-666 (1995). Instead, the Court of Appeals fashioned a test under which the preclusive force of a state court settlement judgment is limited to those claims that "could ... have been extinguished by the issue preclusive effect of an adjudication of the state claims." *Id.*, at 665. The lower courts have taken varying approaches to determining the preclusive effect of a state court judgment, entered in a class or derivative action, that provides for the release of exclusively federal claims.[3] We granted certiorari to clarify this important area of federal law. 515 U.S. 1141, 115 S.Ct. 2576, 132 L.Ed.2d 826 (1995).

II

The Full Faith and Credit Act mandates that the "judicial proceedings" of any State "shall have the same full faith and credit in every court within the United States ... as they have by law or usage in the courts of such State ... from which they are taken." 28 U.S.C. § 1738. The Act thus directs all courts to treat a state court judgment with the same respect that it would

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[3] Compare the decision below with *Grimes v. Vitalink Communications Corp.*, 17 F.3d 1553 (C.A.3), cert. denied, 513 U.S. 986, 115 S.Ct. 480, 130 L.Ed.2d 393 (1994); *Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29 (C.A.1 1991); and *Abramson v. Pennwood Investment Corp.*, 392 F.2d 759 (C.A.2 1968).

receive in the courts of the rendering state. Federal courts may not "employ their own rules ... in determining the effect of state judgments," but must "accept the rules chosen by the State from which the judgment is taken." *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 481-482, 102 S.Ct. 1883, 1898, 72 L.Ed.2d 262 (1982). Because the Court of Appeals failed to follow the dictates of the Act, we reverse.

A

The state court judgment in this case differs in two respects from the judgments that we have previously considered in our cases under the Full Faith and Credit Act. As respondents and the Court of Appeals stressed, the judgment was the product of a class action and incorporated a settlement agreement releasing claims within the exclusive jurisdiction of the federal courts. Though respondents urge "the irrelevance of section 1738 to this litigation," Brief for Respondents 25, we do not think that either of these features exempts the judgment from the operation of § 1738.

That the judgment at issue is the result of a class action, rather than a suit brought by an individual, does not undermine the initial applicability of § 1738. The judgment of a state court in a class action is plainly the product of a "judicial proceeding" within the meaning of § 1738. Cf. *McDonald v. West Branch*, 466 U.S. 284, 287-288, 104 S.Ct. 1799, 1801-1802, 80 L.Ed.2d 302 (1984) (holding that § 1738 does not apply to arbitration awards because arbitration is not a "judicial proceeding"). Therefore, a judgment entered in a class action, like any other judgment entered in a state judicial proceeding, is presumptively entitled to full faith and credit under the express terms of the Act.

Further, § 1738 is not irrelevant simply because the judgment in question might work to bar the litigation of exclusively

federal claims. Our decision in *Marrese v. American Academy of Orthopaedic Surgeons,* 470 U.S. 373, 105 S.Ct. 1327, 84 L.Ed.2d 274 (1985), made clear that where § 1738 is raised as a defense in a subsequent suit, the fact that an allegedly precluded "claim is within the exclusive jurisdiction of the federal courts *does not necessarily make § 1738 inapplicable.*" *Id.,* at 380, 105 S.Ct., at 1332 (emphasis added). In so holding, we relied primarily on *Kremer v. Chemical Constr. Corp., supra,* which held, without deciding whether Title VII claims are exclusively federal, that state court proceedings may be issue preclusive in Title VII suits in federal court. *Kremer,* we said, "implies that absent an exception to § 1738, state law determines at least the ... preclusive effect of a prior state judgment in a subsequent action involving a claim within the exclusive jurisdiction of the federal courts." *Marrese,* 470 U.S., at 381, 105 S.Ct., at 1332. Accordingly, we decided that "a state court judgment may in some circumstances have preclusive effect in a subsequent action within the exclusive jurisdiction of the federal courts." *Id.,* at 380, 105 S.Ct., at 1332.

In *Marrese,* we discussed *Nash County Board of Education v. Biltmore Co.,* 640 F.2d 484 (C.A.4), cert. denied, 454 U.S. 878, 102 S.Ct. 359, 70 L.Ed.2d 188 (1981), a case that concerned a state court settlement judgment. In *Nash,* the question was whether the judgment, which approved the settlement of state antitrust claims, prevented the litigation of exclusively federal antitrust claims. See 470 U.S., at 382, n. 2, 105 S.Ct., at 1333, n. 2. We suggested that the approach outlined in *Marrese* would also apply in cases like *Nash* that involve judgments upon settlement: that is, § 1738 would control at the outset. See *ibid.* In accord with these precedents, we conclude that § 1738 is generally applicable in cases in which the state court judgment at issue incorporates a class action settlement releasing claims solely within the jurisdiction of the federal courts.

B

Marrese provides the analytical framework for deciding whether the Delaware court's judgment precludes this exclusively federal action. When faced with a state court judgment relating to an exclusively federal claim, a federal court must first look to the law of the rendering State to ascertain the effect of the judgment. See *id.*, at 381-382, 105 S.Ct., at 1332-1333. If state law indicates that the particular claim or issue would be barred from litigation in a court of that state, then the federal court must next decide whether, "as an exception to § 1738," it "should refuse to give preclusive effect to [the] state court judgment." *Id.*, at 383, 105 S.Ct., at 1333. See also Migra v. Warren City School Dist. Bd. of Ed., 465 U.S. 75, 80, 104 S.Ct. 892, 896, 79 L.Ed.2d 56 (1984) ("[I]n the absence of federal law modifying the operation of § 1738, the preclusive effect in federal court of [a] state-court judgment is determined by [state] law").

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We observed in *Marrese* that the inquiry into state law would not always yield a direct answer. Usually, "a state court will not have occasion to address the specific question whether a state judgment has issue or claim preclusive effect in a later action that can be brought only in federal court." 470 U.S., at 381-382, 105 S.Ct., at 1332. Where a judicially approved settlement is under consideration, a federal court may consequently find guidance from general state law on the preclusive force of settlement judgments. See, *e.g.*, *id.*, at 382-383, n. 2, 105 S.Ct., at 1333, n. 2 (observing in connection with *Nash* that "[North Carolina] law gives preclusive effect to consent judgment[s]"). Here, in addition to providing rules regarding the preclusive force of class-action settlement judgments in subsequent suits in state court, the Delaware

courts have also spoken to the particular effect of such judgments in federal court.

Delaware has traditionally treated the impact of settlement judgments on subsequent litigation in state court as a question of claim preclusion. Early cases suggested that Delaware courts would not afford claim preclusive effect to a settlement releasing claims that could not have been presented in the trial court. See *Ezzes v. Ackerman,* 234 A.2d 444, 445-446 (Del.1967) ("[A] judgment entered either after trial on the merits or upon an approved settlement is *res judicata* and bars subsequent suit on the same claim.... [T]he defense of *res judicata* ... is available if the pleadings framing the issues in the first action would have permitted the raising of the issue sought to be raised in the second action, and if the facts were known or could have been known to the plaintiff in the second action at the time of the first action"). As the Court of Chancery has perceived, however, "the *Ezzes* inquiry [was] modified in regard to class actions," *In re Union Square Associates Securities Litigation,* C.A. No. 11028, 1993 WL 220528, *3 (June 16, 1993), by the Delaware Supreme Court's decision in *Nottingham Partners v. Dana,* 564 A.2d 1089 (1989).

In *Nottingham,* a class action, the Delaware Supreme Court approved a settlement that released claims then pending in federal court. In approving that settlement, the *Nottingham* Court appears to have eliminated the *Ezzes* requirement that the claims could have been raised in the suit that produced the settlement, at least with respect to class actions:

> " '[I]n order to achieve a comprehensive settlement that would prevent relitigation of settled questions at the core of a class action, a court may permit the release of a claim based on the identical factual predicate as that underlying the claims in the settled class action even

> though the claim was not presented and might not have been presentable in the class action.' " 564 A.2d, at 1106 (quoting *TBK Partners, Ltd. v. Western Union Corp.*, 675 F.2d 456, 460 (C.A.2 1982)).

See *Union Square,* C.A. No. 11028, 1993 WL 220528, *3 (relying directly on *Nottingham* to hold that a Delaware court judgment settling a class action was res judicata and barred arbitration of duplicative claims that could not have been brought in the first suit). These cases indicate that even if, as here, a claim could not have been raised in the court that rendered the settlement judgment in a class action, a Delaware court would still find that the judgment bars subsequent pursuit of the claim.

The Delaware Supreme Court has further manifested its understanding that when the Court of Chancery approves a global release of claims, its settlement judgment should preclude on-going or future federal court litigation of any released claims. In *Nottingham,* the Court stated that "[t]he validity of executing a general release in conjunction with the termination of litigation has long been recognized by the Delaware courts. More specifically, the Court of Chancery has a history of approving settlements that have implicitly or explicitly included a general release, which would also release federal claims." 564 A.2d, at 1105 (citation omitted). Though the Delaware Supreme Court correctly recognized in *Nottingham* that it lacked actual authority to order the dismissal of any case pending in federal court, it asserted that state-court approval of the settlement would have the collateral effect of preventing class members from prosecuting their claims in federal court. Perhaps the clearest statement of the Delaware Chancery Court's view on this matter was articulated in the suit preceding this one: "When a state court settlement of a class action releases all claims which arise out of the challenged

transaction and is determined to be fair and to have met all due process requirements, the class members are bound by the release or the doctrine of issue preclusion. Class members cannot subsequently relitigate the claims barred by the settlement in a federal court." *In re MCA, Inc. Shareholders Litigation,* 598 A.2d 687, 691 (1991).[4] We are aware of no Delaware case that suggests otherwise.

Given these statements of Delaware law, we think that a Delaware court would afford preclusive effect to the settlement judgment in this case, notwithstanding the fact that respondents could not have pressed their Exchange Act claims in the Court of Chancery. The claims are clearly within the scope of the release in the judgment, since the judgment specifically refers to this lawsuit. As required by Delaware Court of Chancery Rule 23, see *Prezant v. De Angelis,* 636 A.2d 915, 920 (1994), the Court of Chancery found, and the Delaware Supreme Court affirmed, that the settlement was "fair, reasonable and adequate and in the best interests of the ... Settlement class" and that notice to the class was "in full compliance with ... the requirements of due process." *In re MCA Inc. Shareholders Litigation,* C.A. No. 11740 (Feb. 22, 1993), reprinted in App. to Pet. for Cert. 73a, 74a. Cf. *Phillips Petroleum Co. v. Shutts,* 472 U.S. 797, 812, 105 S.Ct. 2965, 2974, 86 L.Ed.2d 628 (1985) (due process for class action plaintiffs requires "notice plus an opportunity to be heard and participate in the litigation"). The Court of Chancery "further determined that

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[4] In fact, the Chancery Court rejected the first settlement, which contained no opt-out provision, as unfair to the class precisely because it believed that the settlement would preclude the class from pursuing their exclusively federal claims in federal court. See *In re MCA Inc. Shareholders Litigation,* 598 A.2d 687, 692 (1991) ("[I]f this Court provides for the release of all the claims arising out of the challenged transaction, the claims which the Objectors have asserted in the federal suit will likely be forever barred").

the plaintiffs[,] ... as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class." *In re MCA, Inc. Shareholders Litigation, supra,* reprinted in App. to Pet. for Cert. 73a. Cf. *Phillips Petroleum Co., supra,* at 812, 105 S.Ct., at 2974 (due process requires "that the named plaintiff at all times adequately represent the interests of the absent class members").[5] Under Delaware Rule 23, as under Federal Rule of Civil Procedure 23, "[a]ll members of the class, whether of a plaintiff or a defendant class, are bound by the judgment entered in the action unless, in a Rule 23(b)(3) action, they make a timely election for exclusion." 2 H. Newberg, Class Actions § 2755, p. 1224 (1977). See also *Cooper v. Federal Reserve Bank of Richmond,* 467 U.S. 867, 874, 104 S.Ct. 2794, 2798, 81 L.Ed.2d 718 (1984) ("There is of course no dispute that under elementary principles of prior adjudication a judgment in a properly entertained class action is binding on class members in any subsequent litigation"). Respondents do not deny that, as shareholders of MCA's common stock, they were part of the

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[5] A part from any discussion of Delaware law, respondents contend that the settlement proceedings did not satisfy due process because the class was inadequately represented. See Brief for Respondents 34-45. Respondents make this claim in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class. Cf. *Prezant v. De Angelis,* 636 A.2d 915, 923 (Del.1994) ("[The] constitutional requirement [of adequacy of representation] is embodied in [Delaware] Rule 23(a)(4), which requires that the named plaintiff 'fairly and adequately protect the interests of the class' "). We need not address the due process claim, however, because it is outside the scope of the question presented in this Court. See *Yee v. Escondido,* 503 U.S. 519, 533, 112 S.Ct. 1522, 1531, 118 L.Ed.2d 153 (1992). While it is true that a respondent may defend a judgment on alternative grounds, we generally do not address arguments that were not the basis for the decision below. See *Peralta v. Heights Medical Center, Inc.,* 485 U.S. 80, 86, 108 S.Ct. 896, 899, 99 L.Ed.2d 75 (1988).

plaintiff class and that they never opted out; they are bound, then, by the judgment.[6]

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Because it appears that the settlement judgment would be res judicata under Delaware law, we proceed to the second step of the *Marrese* analysis and ask whether § 27 of the Exchange Act, which confers exclusive jurisdiction upon the federal courts for suits arising under the Act, partially repealed § 1738. Section 27 contains no express language regarding its relationship with § 1738 or the preclusive effect of related state court proceedings. Thus, any modification of § 1738 by § 27 must be implied. In deciding whether § 27 impliedly created an exception to § 1738, the "general question is whether the concerns underlying a particular grant of exclusive jurisdiction justify a finding of an implied partial repeal of § 1738." *Marrese,* 470 U.S., at 386, 105 S.Ct., at 1334. "Resolution of this question will depend on the particular federal statute as well as the nature of the claim or issue involved in the subsequent federal action.... [T]he primary consideration must be the intent of Congress." *Ibid.*

As an historical matter, we have seldom, if ever, held that a federal statute impliedly repealed § 1738. See *Parsons Steel,*

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[6] Respondents argue that their failure to opt out of the settlement class does not constitute consent to the terms of the settlement under traditional contract principles. Brief for Respondents 16-25. Again, the issue raised by respondents--whether the settlement could bar this suit as a matter of contract law, as distinguished from § 1738 law--is outside the scope of the question on which we granted certiorari. We note, however, that if a State chooses to approach the preclusive effect of a judgment embodying the terms of a settlement agreement as a question of pure contract law, a federal court must adhere to that approach under § 1738. *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 481-482, 102 S.Ct. 1883, 1897-1898, 72 L.Ed.2d 262 (1982).

Inc. v. First Alabama Bank, 474 U.S. 518, 523-524, 106 S.Ct. 768, 771-772, 88 L.Ed.2d 877 (1986) (Anti-Injunction Act does not limit § 1738); *Migra v. Warren City School Dist. Bd. of Ed.,* 465 U.S. 75, 83-85, 104 S.Ct. 892, 897-898, 79 L.Ed.2d 56 (1984) (§ 1983 does not limit claim preclusion under § 1738); *Kremer v. Chemical Constr. Corp.,* 456 U.S. 461, 468-476, 102 S.Ct. 1883, 1890-1895, 72 L.Ed.2d 262 (1982) (Title VII of the Civil Rights Act of 1964 does not limit § 1738); *Allen v. McCurry,* 449 U.S. 90, 96-105, 101 S.Ct. 411, 415-421, 66 L.Ed.2d 308 (1980) (§ 1983 does not limit issue preclusion under § 1738). But cf. *Brown v. Felsen,* 442 U.S. 127, 138-139, 99 S.Ct. 2205, 2212-2213, 60 L.Ed.2d 767 (1979) (declining to give claim preclusive effect to prior state court debt collection proceeding in federal bankruptcy suit, without discussing § 1738, state law or implied repeals). The rarity with which we have discovered implied repeals is due to the relatively stringent standard for such findings, namely, that there be an " 'irreconcilable conflict' " between the two federal statutes at issue. *Kremer v. Chemical Constr. Corp., supra,* at 468, 102 S.Ct., at 1890 (quoting *Radzanower v. Touche Ross & Co.,* 426 U.S. 148, 154, 96 S.Ct. 1989, 1993, 48 L.Ed.2d 540 (1976)).

Section 27 provides that "[t]he district courts of the United States ... shall have exclusive jurisdiction ... of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder." 15 U.S.C. § 78aa. There is no suggestion in § 27 that Congress meant for plaintiffs with Exchange Act claims to have more than one day in court to challenge the legality of a securities transaction. Though the statute plainly mandates that suits alleging violations of the Exchange Act may be maintained only in federal court, nothing in the language of § 27 "remotely expresses any congressional intent to contravene the common- law rules of preclusion or to repeal the express

statutory requirements of ... 28 U.S.C. § 1738." *Allen v. McCurry, supra,* at 97-98, 101 S.Ct., at 416.

Nor does § 27 evince any intent to prevent litigants in state court-- whether suing as individuals or as part of a class--from voluntarily releasing Exchange Act claims in judicially approved settlements. While § 27 prohibits state courts from adjudicating claims arising under the Exchange Act, it does not prohibit state courts from approving the release of Exchange Act claims in the settlement of suits over which they have properly exercised jurisdiction, *i.e.*, suits arising under state law or under federal law for which there is concurrent jurisdiction. In this case, for example, the Delaware action was not "brought to enforce" any rights or obligations under the Act. The Delaware court asserted judicial power over a complaint asserting purely state law causes of action[7] and, after the parties agreed to settle, certified the class and approved the settlement pursuant to the requirements of Delaware Rule of Chancery 23 and the Due Process Clause. Thus, the Delaware court never trespassed upon the exclusive territory of the federal courts, but merely approved the settlement of a common-law suit pursuant to state and nonexclusive federal law. See *Abramson v. Pennwood Investment Corp.*, 392 F.2d 759, 762 (C.A.2 1968) ("Although the state court could not adjudicate the federal claim, it was within its powers over the corporation and the parties to approve the release of that claim as a condition of settlement of the state action"). While it is true that the state court assessed the general worth of the federal claims in determining the fairness of the settlement, such assessment does not amount to a judgment on the merits of the claims. See *TBK Partners, Ltd. v. Western Union Corp.*, 675 F.2d 456, 461

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[7] Though the plaintiff class premised one of its claims of fiduciary breach on the allegation that MCA wasted corporate assets by exposing the corporation to liability under the federal securities laws, the cause pled was nonetheless a state common-law action for breach of fiduciary duty.

(C.A.2 1982) (" 'Approval of a settlement does not call for findings of fact regarding the claims to be compromised. The court is concerned only with the *likelihood* of success or failure; the actual merits of the controversy are not to be determined' ") (quoting Haudek, The Settlement and Dismissal of Stockholders' Actions-Part II: The Settlement, 23 Sw.L.J. 765, 809 (1969) (footnotes omitted)). The Delaware court never purported to resolve the merits of the Exchange Act claims in the course of appraising the settlement; indeed, it expressly disavowed that purpose. See *In re MCA, Inc. Shareholders Litigation,* C.A. No. 11740, 1993 WL 43024 (Feb. 16, 1993), reprinted in App. to Pet. for Cert. 68a ("In determining whether a settlement should be approved, a court should not try the merits of the underlying claims. This principle would seem to be especially appropriate where the underlying claims, like the federal claims here, are outside the jurisdiction of this Court" (citation omitted)).

The legislative history of the Exchange Act elucidates no specific purpose on the part of Congress in enacting § 27. See *Murphy v. Gallagher,* 761 F.2d 878, 885 (C.A.2 1985) (noting that the legislative history of the Exchange Act provides no readily apparent explanation for the provision of exclusive jurisdiction in § 27) (citing 2 & 3 L. Loss, Securities Regulation 997, 2005 (2d ed.1961)). We may presume, however, that Congress intended § 27 to serve at least the general purposes underlying most grants of exclusive jurisdiction: "to achieve greater uniformity of construction and more effective and expert application of that law." *Murphy v. Gallagher, supra,* at 885. When a state court upholds a settlement that releases claims under the Exchange Act, it threatens neither of these policies. There is no danger that state court judges who are not fully expert in federal securities law will say definitively what the Exchange Act means and enforce legal liabilities and duties thereunder. And the uniform construction of the Act is unaffected by a state court's approval

of a proposed settlement because the state court does not adjudicate the Exchange Act claims but only evaluates the overall fairness of the settlement, generally by applying its own business judgment to the facts of the case. See, *e.g., Polk v. Good,* 507 A.2d 531, 535 (Del.1986).

Furthermore, other provisions of the Exchange Act suggest that Congress did not intend to create an exception to § 1738 for suits alleging violations of the Act. Congress plainly contemplated the possibility of dual litigation in state and federal courts relating to securities transactions. See 15 U.S.C. § 78bb(a) (preserving "all other rights and remedies that may exist at law or in equity"). And all that Congress chose to say about the consequences of such litigation is that plaintiffs ought not obtain double recovery. See *ibid.* Congress said nothing to modify the background rule that where a state-court judgment precedes that of a federal court, the federal court must give full faith and credit to the state court judgment. See *Murphy v. Gallagher, supra,* at 884.

Finally, precedent supports the conclusion that the concerns underlying the grant of exclusive jurisdiction in § 27 are not undermined by state-court approval of settlements releasing Exchange Act claims. We have held that state court proceedings may, in various ways, subsequently affect the litigation of exclusively federal claims without running afoul of the federal jurisdictional grant in question. In *Becher v. Contoure Laboratories, Inc.*, 279 U.S. 388, 49 S.Ct. 356, 73 L.Ed. 752 (1929) (cited in *Marrese,* 470 U.S., at 381, 105 S.Ct., at 1332), we held that state court findings of fact were issue preclusive in federal patent suits. We did so with full recognition that "the logical conclusion from the establishing of [the state law] claim is that Becher's patent is void." 279 U.S., at 391, 49 S.Ct., at 357. *Becher* reasoned that although "decrees validating or invalidating patents belong to the Courts of the United States," that "does not give sacrosanctity to facts

that may be conclusive upon the question in issue." *Ibid.* Similarly, while binding legal determinations of rights and liabilities under the Exchange Act are for federal courts only, there is nothing sacred about the approval of settlements of suits arising under state law, even where the parties agree to release exclusively federal claims. See also *Brown v. Felsen,* 442 U.S., at 139, n. 10, 99 S.Ct., at 2213, n. 10 (noting that "[i]f, in the course of adjudicating a state-law question, a state court should determine factual issues using standards identical to those of § 17, then collateral estoppel, in the absence of countervailing statutory policy, would bar relitigation of those issues in the bankruptcy court"); *Pratt v. Paris Gaslight & Coke Co.,* 168 U.S. 255, 258, 18 S.Ct. 62, 63, 42 L.Ed. 458 (1897) (when a state court has jurisdiction of the parties and the subject matter of the complaint, the state court may decide the validity of a patent when that issue is raised as a defense).

We have also held that Exchange Act claims may be resolved by arbitration rather than litigation in federal court. In *Shearson/ American Express Inc. v. McMahon,* 482 U.S. 220, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987), we found that parties to an arbitration agreement could waive the right to have their Exchange Act claims tried in federal court and agree to arbitrate the claims. *Id.,* at 227-228, 107 S.Ct., at 2337-2338. It follows that state court litigants ought also to be able to waive, or "release," the right to litigate Exchange Act claims in a federal forum as part of a settlement agreement. As *Shearson/American Express Inc.* demonstrates, a statute conferring exclusive federal jurisdiction for a certain class of claims does not necessarily require resolution of those claims in a federal court.

Taken together, these cases stand for the general proposition that even when exclusively federal claims are at stake, there is no "universal right to litigate a federal claim in a federal district court." *Allen* v. *McCurry,* 449 U.S., at 105, 101 S.Ct., at 420.

If class action plaintiffs wish to preserve absolutely their right to litigate exclusively federal claims in federal court, they should either opt out of the settlement class or object to the release of any exclusively federal claims. In fact, some of the plaintiffs in the Delaware class action requested exclusion from the settlement class. They are now proceeding in federal court with their federal claims, unimpeded by the Delaware judgment.

In the end, §§ 27 and 1738 "do not pose an either-or proposition." *Connecticut Nat. Bank v. Germain,* 503 U.S. 249, 253, 112 S.Ct. 1146, 1149, 117 L.Ed.2d 391 (1992). They can be reconciled by reading § 1738 to mandate full faith and credit of state court judgments incorporating global settlements, provided the rendering court had jurisdiction over the underlying suit itself, and by reading § 27 to prohibit state courts from exercising jurisdiction over suits arising under the Exchange Act. Cf. C. Wright, A. Miller, & E. Cooper, Federal Practice and Procedure § 4470 pp. 688-689 (1981) ("[S]ettlement of state court litigation has been held to defeat a subsequent federal action if the settlement was intended to apply to claims in exclusive federal jurisdiction as well as other claims.... These rulings are surely correct"). Congress' intent to provide an exclusive federal forum for adjudication of suits to enforce the Exchange Act is clear enough. But we can find no suggestion in § 27 that Congress meant to override the "principles of comity and repose embodied in § 1738," *Kremer v. Chemical Constr. Corp.,* 456 U.S., at 463, 102 S.Ct., at 1888, by allowing plaintiffs with Exchange Act claims to release those claims in state court and then litigate them in federal court. We conclude that the Delaware courts would give the settlement judgment preclusive effect in a subsequent proceeding and, further, that § 27 did not effect a partial repeal of § 1738.

C

The Court of Appeals did not engage in any analysis of Delaware law pursuant to § 1738. Rather, the Court of Appeals declined to apply § 1738 on the ground that where the rendering forum lacked jurisdiction over the subject matter or the parties, full faith and credit is not required. 50 F.3d, at 661, 666. See *Underwriters Nat. Assurance Co. v. North Carolina Life & Accident & Health Ins. Guaranty Assn.*, 455 U.S. 691, 704-705, 102 S.Ct. 1357, 1366, 71 L.Ed.2d 558 (1982) (" '[A] judgment of a court in one State is conclusive upon the merits in a court in another State only if the court in the first State had power to pass on the merits--had jurisdiction, that is, to render the judgment' ") (quoting *Durfee v. Duke*, 375 U.S. 106, 110, 84 S.Ct. 242, 244, 11 L.Ed.2d 186 (1963)). The Court of Appeals decided that the subject-matter jurisdiction exception to full faith and credit applies to this case because the Delaware court acted outside the bounds of its own jurisdiction in approving the settlement, since the settlement released exclusively federal claims. See 50 F.3d, at 661-662, and n. 25.

As explained above, the state court in this case clearly possessed jurisdiction over the subject matter of the underlying suit and over the defendants. Only if this were not so--for instance, if the complaint alleged violations of the Exchange Act and the Delaware court rendered a judgment on the merits of those claims--would the exception to § 1738 for lack of subject-matter jurisdiction apply. Where, as here, the rendering court in fact had subject-matter jurisdiction, the subject-matter jurisdiction exception to full faith and credit is simply inapposite. In such a case, the relevance of a federal statute that provides for exclusive federal jurisdiction is not to the state

court's possession of jurisdiction *per se,* but to the existence of a partial repeal of § 1738.[8]

* * *

The judgment of the Court of Appeals is reversed and remanded for proceedings consistent with this opinion.

It is so ordered.

Justice STEVENS, concurring in part and dissenting in part.

While I join Parts I, II-A, and II-C of the Court's opinion, and while I also agree with the Court's reasons for concluding that § 27 of the Exchange Act does not create an implied partial repeal of the Full Faith and Credit Act, I join neither Part II-B nor the Court's judgment because I agree with Justice GINSBURG that the question of Delaware law should be addressed by the Court of Appeals in the first instance, and that the Ninth Circuit remains free to consider whether Delaware courts fully and fairly litigated the adequacy of class representation.

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[8] *Kalb v. Feuerstein,* 308 U.S. 433, 60 S.Ct. 343, 84 L.Ed. 370 (1940), is not to the contrary. In that case, the federal statute at issue expressly prohibited certain common-law actions from being either instituted or maintained in state court. *Id.,* at 440-441, 60 S.Ct., at 346-347. Thus, by merely entertaining a common-law foreclosure suit, over which it otherwise would have had jurisdiction, the state court violated the terms of the Act. That is not the situation here, where there is no contention that just by entertaining the class action the Delaware court acted in violation of federal law.

Justice GINSBURG, with whom Justice STEVENS joins, and with whom Justice SOUTER joins as to Part II-B, concurring in part and dissenting in part.

I join the Court's judgment to the extent that it remands the case to the Ninth Circuit. I agree that a remand is in order because the Court of Appeals did not attend to this Court's reading of 28 U.S.C. § 1738 in a controlling decision, *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 102 S.Ct. 1883, 72 L.Ed.2d 262 (1982). But I would not endeavor, as the Court does, to speak the first word on the content of Delaware preclusion law. Instead, I would follow our standard practice of remitting that issue for decision, in the first instance, by the lower federal courts. See, *e.g., Marrese v. American Academy of Orthopaedic Surgeons,* 470 U.S. 373, 387, 105 S.Ct. 1327, 1335, 84 L.Ed.2d 274 (1985).

I write separately to emphasize a point key to the application of § 1738: A state-court judgment generally is not entitled to full faith and credit unless it satisfies the requirements of the Fourteenth Amendment's Due Process Clause. See *Kremer,* 456 U.S., at 482-483, 102 S.Ct., at 1898- 1899. In the class action setting, adequate representation is among the due process ingredients that must be supplied if the judgment is to bind absent class members. See *Phillips Petroleum Co. v. Shutts,* 472 U.S. 797, 808, 812, 105 S.Ct. 2965, 2972, 2974, 86 L.Ed.2d 628 (1985); *Prezant v. De Angelis,* 636 A.2d 915, 923-924 (Del.1994).

Suitors in this action (called the "Epstein plaintiffs" in this opinion), respondents here, argued before the Ninth Circuit, and again before this Court, that they cannot be bound by the Delaware settlement because they were not adequately represented by the Delaware class representatives. They contend that the Delaware representatives' willingness to release federal securities claims within the exclusive

jurisdiction of the federal courts for a meager return to the class members, but a solid fee to the Delaware class attorneys, disserved the interests of the class, particularly, the absentees. The inadequacy of representation was apparent, the Epstein plaintiffs maintained, for at the time of the settlement, the federal claims were *sub judice* in the proper forum for those claims--the federal judiciary. Although the Ninth Circuit decided the case without reaching the due process check on the full faith and credit obligation, that inquiry remains open for consideration on remand. See *ante,* at 11, n. 5 (due process "w[as] not the basis for the decision below," so the Court "need not address [it]").

I

Matsushita's acquisition of MCA prompted litigation in state and federal courts. A brief account of that litigation will facilitate comprehension of the Epstein plaintiffs' position. On September 26, 1990, in response to reports in the financial press that Matsushita was negotiating to buy MCA, a suit was filed in the Court of Chancery of Delaware, a purported class action on behalf of the stockholders of MCA. Naming MCA and its directors (but not Matsushita) as defendants, the complaint invoked state law only. It alleged that MCA's directors had failed to carry out a market check to maximize shareholder value upon a change in corporate control, a check required by *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del.1986). For this alleged breach of fiduciary duty, the complaint sought, *inter alia,* an injunction against Matsushita's proposed acquisition of MCA.

Matsushita announced its tender offer on November 26, 1990. It offered holders of MCA common stock $71 per share, if they tendered their shares before December 29, 1990. The owners of 91% of MCA's common stock tendered their shares and, on

January 3, 1991, for a price of $6.1 billion, Matsushita acquired MCA.

On December 3, 1990, a few days after the required SEC filings disclosed the terms of the tender offer, several MCA shareholders filed suit in the United States District Court for the Central District of California.[1] Based solely on federal law, their complaints alleged that Matsushita, first named defendant, violated SEC Rules 14d-10, 17 CFR § 240.14d-10 (1994), and 10b-13, 17 CFR § 240.10b-13 (1994), by offering preferential treatment in the tender offer to MCA principals Lew Wasserman and Sidney Sheinberg. As stated in the complaint, the public tender offer included a special tax-driven stock swap arrangement for Wasserman, then MCA's chairman and chief executive officer, and a $21 million bonus for Sheinberg, then MCA's chief operating officer and owner of 1,170,000 shares of MCA common stock. These arrangements allegedly violated, *inter alia,* the SEC's "all-holder best-price" rule (Rule 14d-10), which requires bidders to treat all shareholders on equal terms. The claims of federal securities law violations fell within the exclusive jurisdiction of the federal court. See 15 U.S.C. § 78aa. The Epstein plaintiffs also sought class certification to represent all MCA shareholders at the time of the tender offer.

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[1] Two sets of plaintiffs filed complaints in the Central District of California: the Epstein plaintiffs (including Lawrence Epstein, John Linder, Jane Rockford, Maurice Karlin, Ruth Karlin, Beth Karlin, and Bert Karlin) sued both individually and on behalf of all MCA shareholders at the time of the tender offer; Walter Minton brought suit in his individual capacity. All had tendered their shares for the $71 tender price. The District Court consolidated the two cases. Minton and, it appears, Rockford opted out of the Delaware class action settlement. Matsushita does not contest the qualification of Minton and Rockford, as individuals, to pursue federal claims unimpeded by the settlement in Delaware. See Brief for Petitioners ii. Matsushita does contest any class action initiative in federal court.

Two days later, counsel in the Delaware action advised MCA's counsel that the Delaware plaintiffs intended to amend their complaint to include additional claims against MCA and its directors and to add Matsushita as a defendant. The additional claims alleged that MCA wasted corporate assets by increasing the corporation's exposure to liability for violation of Rules 10b- 13 and 14d-10, that MCA failed to make full disclosure of the benefits MCA insiders would receive from the takeover, and that directors Wasserman and Sheinberg breached their fiduciary duties by negotiating preferential deals with Matsushita. Matsushita, the amended complaint alleged, had conspired with and aided and abetted MCA directors in violation of Delaware law.

Within days, the Delaware parties agreed to a settlement and, on December 17, 1990, submitted their proposal to the Delaware Vice Chancellor. The agreement provided for a modification of a "poison pill" in the corporate charter of an MCA subsidiary,[2] and for a fees payment of $1 million to the class counsel. The settlement agreement required the release of all claims, state and federal, arising out of the tender offer.

The Vice Chancellor rejected the settlement agreement on April 22, 1991, for two reasons: the absence of any monetary benefit to the class members; and the potential value of the federal claims that the agreement proposed to release. The "generous payment" of $1 million in counsel fees, the Vice Chancellor observed, "confer[red] no benefit on the members of the Class." *In re MCA, Inc. Shareholders Litigation,* 598 A.2d 687, 695 (Del.Ch.1991). And the value of the revised poison pill to the

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[2] The subsidiary in question was spun off from MCA during the merger because it owned a television station that federal law prohibited Matsushita from acquiring. The $71 tender offer price included $5 worth of stock in this new corporation.

class, the Vice Chancellor said, was "illusionary[,] ... apparently ... proposed merely to justify a settlement which offers no real monetary benefit to the Class." *Id.*, at 696. The Vice Chancellor described the state-law claims as "at best, extremely weak and, therefore, [of] little or no value." *Id.*, at 694. "[T]he only claims which have any substantial merit," he said, "are the claims ... in the California federal suit that were not asserted in this Delaware action." *Id.*, at 696. After the rejection of the settlement, the Delaware lawsuit lay dormant for more than a year.

The federal litigation proceeded. In various rulings, the District Court denied the federal plaintiffs' motion for partial summary judgment, denied the Epstein plaintiffs' motion for class certification, and granted Matsushita's motion for summary judgment dismissing the claims. On April 15, 1992, the District Court entered its final judgment, which the Epstein plaintiffs appealed to the Ninth Circuit.

On October 22, 1992, after the federal plaintiffs had filed their notice of appeal, the Delaware parties reached a second settlement agreement. Matsushita agreed to create a $2 million settlement fund that would afford shareholders 2 to 3 cents per share before payment of fees and costs. The Delaware class counsel requested $691,000 in fees. In return for this relief, the Delaware plaintiffs agreed to release "all claims, rights and causes of action (state or federal, including but not limited to claims arising under the federal securities laws, and any rules or regulations promulgated thereunder, or otherwise) ... in connection with or that arise now or hereafter out of the [tender offer] ... including without limitation the claims asserted in the California Federal Actions...." App. 187-188. Unlike the first settlement proposal, the second agreement included an opt-out provision.

This time the Vice Chancellor approved the settlement. He stated "it is in the best interests of the class to settle this litigation and the terms of the settlement are fair and reasonable--although the value of the benefit to the class is meager." *In re MCA, Inc. Shareholders Litigation,* C.A. No. 11740, 1993 WL 43024, *1 (Del.Ch., Feb.16, 1993). He found the class members' recovery of 2 to 3 cents per share "adequate (if only barely so) to support the proposed settlement." *Id.,* at *4. The federal claims, he reasoned, having been dismissed by the District Court, "now have minimal economic value." *Ibid.* And he gave weight to the presence in the second settlement agreement of an opt-out provision. *Ibid.*

Addressing the objectors' contention that the proposed settlement was "collusive," the Vice Chancellor recalled that "the settling parties ha[d] previously proposed a patently inadequate settlement," and he agreed that "suspicions abound." *Id.,* at *5. Nevertheless, he noted, the "[o]bjectors have offered no evidence of any collusion," so he declined to reject the settlement on that ground. *Ibid.* Reducing the counsel fees from the requested $691,000 to $250,000, the Vice Chancellor offered this observation: "[T]he defendants' willingness to create the settlement fund seems likely to have been motivated as much by their concern as to their potential liability under the federal claims as by their concern for liability under the state law claims which this Court characterized as 'extremely weak.'" *Id.,* at *6. In a brief order, the Delaware Supreme Court affirmed "on the basis of and for the reasons assigned by the Court of Chancery...." *In re MCA, Inc. Shareholders Litigation,* C.A. No. 126,1993, 1993 WL 385041, *1 (Sept. 21, 1993), judgt. order reported at 633 A.2d 370.

Before the Ninth Circuit, Matsushita argued that the Delaware class action settlement barred litigation of the federal claims raised in the Epstein action. The Ninth Circuit disagreed.

Relying on federal circuit court decisions,[3] the Court of Appeals held that state courts lack plenary power to approve settlements that effectively extinguish exclusively federal claims. Only if federal and state claims rest on the "identical factual predicate," the Ninth Circuit concluded, could a state court settlement subsume an exclusively federal claim. It was not enough, in the Ninth Circuit's view, that the discrete federal and state claims stem from the "same transaction," the test Matsushita urged. 50 F.3d, at 661-665. The federal securities claims did not turn on the same operative facts as the state claims pleaded in Delaware, the Ninth Circuit found; accordingly, the federal claims could not have been extinguished by the issue-preclusive effect of an adjudication of the state claims. This analysis led the Ninth Circuit to declare that the Delaware decree "exceed[ed] the jurisdiction of the state court and, therefore, is not entitled to full faith and credit." *Id.*, at 666.

On the merits, the Ninth Circuit held, first, that a private right of action could be maintained to redress Rule 14d-10 violations. *Id.*, at 652. The court next held that Matsushita violated Rule 14d-10 by paying Wasserman consideration not offered to other shareholders, *id.*, at 657; reversing the District Court's disposition of this matter, the Ninth Circuit held that plaintiffs were entitled to summary judgment on liability and remanded for a determination of damages, *ibid.* Regarding plaintiffs' claim that the $21 million payment to Sheinberg violated Rule 14d-10, the Ninth Circuit vacated the summary judgment for Matsushita and remanded for a determination whether the payment was in fact made to encourage Sheinberg to tender his shares. *Id.*, at 659.

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[3] Closest in point, the court said, were *Grimes v. Vitalink Communications Corp.*, 17 F.3d 1553 (C.A.3 1994), and *Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29 (C.A.1 1991). See *Epstein v. MCA, Inc.*, 50 F.3d 644, 662 (C.A.9 1995).

II

A

Section 1738's full faith and credit instruction, as the Court indicates, requires the forum asked to recognize a judgment first to determine the preclusive effect the judgment would have in the rendering court. See *Kremer*, 456 U.S., at 466, 102 S.Ct., at 1889; *Marrese*, 470 U.S., at 381, 105 S.Ct., at 1332. Because the Ninth Circuit did not evaluate the preclusive effect of the Delaware judgment through the lens of that State's preclusion law, I would remand for that determination. See *id.*, at 386-387, 105 S.Ct., at 1335; *Migra v. Warren City School Dist. Bd. of Ed.*, 465 U.S. 75, 87, 104 S.Ct. 892, 899, 79 L.Ed.2d 56 (1984) ("Prudence ... dictates that it is the District Court, in the first instance, not this Court, that should interpret Ohio preclusion law and apply it.").[4]

B

Every State's law on the preclusiveness of judgments is pervasively affected by the supreme law of the land. To be valid in the rendition forum, and entitled to recognition nationally, a state court's judgment must measure up to the requirements of the Fourteenth Amendment's Due Process Clause. *Kremer*, 456 U.S., at 482-483, 102 S.Ct., at 1898-1899. "A State may not grant preclusive effect in its own courts to a constitutionally infirm judgment, and other state and federal courts are not required to accord full faith and credit to such a judgment." *Id.*, at 482, 102 S.Ct., at 1898 (footnote omitted).

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[4] In its endeavor to forecast Delaware preclusion law, the Court appears to have blended the "identical factual predicate" test applied by the Delaware Supreme Court in *Nottingham Partners v. Dana*, 564 A.2d 1089, 1106-1107 (1989), with the broader "same transaction" test advanced by Matsushita. See *ante*, at 879-880.

In *Phillips Petroleum Co. v. Shutts,* this Court listed minimal procedural due process requirements a class action money judgment must meet if it is to bind absentees; those requirements include notice, an opportunity to be heard, a right to opt out, and adequate representation. 472 U.S., at 812, 105 S.Ct., at 2974. "[T]he Due Process Clause of course requires that the named plaintiff at all times adequately represent the interests of the absent class members." *Ibid.* (citing *Hansberry v. Lee,* 311 U.S. 32, 42-43, 45, 61 S.Ct. 115, 118-119, 120, 85 L.Ed. 22 (1940)). As the *Shutts* Court's phrase "at all times" indicates, the class representative's duty to represent absent class members adequately is a continuing one. 472 U.S., at 812, 105 S.Ct., at 2974; see also *Gonzales v. Cassidy,* 474 F.2d 67, 75 (C.A.5 1973) (representative's failure to pursue an appeal rendered initially adequate class representation inadequate, so that judgment did not bind the class).

Although emphasizing the constitutional significance of the adequate representation requirement, this Court has recognized the first line responsibility of the states themselves for assuring that the constitutional essentials are met. See *Hansberry,* 311 U.S., at 42, 61 S.Ct., at 118.[5] Final judgments, however,

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[5] Many States, including Delaware, have class action rules corresponding to Federal Rule of Civil Procedure 23, a rule ranking adequacy of representation as a prerequisite to maintaining a class action. See 3 H. Newberg & A. Conte, Newberg on Class Actions, App. 13-1 (3d ed.1992) (listing 39 States and the District of Columbia with rules comparable to the amended Federal Rule of Civil Procedure 23); Fed. Rule Civ. Proc. 23(a)(4) (representatives may sue on behalf of the class only if "the representative parties will fairly and adequately protect the interests of the class"); see also *General Telephone Co. of Southwest v. Falcon,* 457 U.S. 147, 157-158, n. 13, 102 S.Ct. 2364, 2370-2371, n. 13, 72 L.Ed.2d 740 (1982) (Federal Rule of Civil Procedure 23(a)(4)'s adequate representation requirement "raises concerns about the competency of class counsel and conflicts of interest," in addition to the question whether the representative

(continued...)

remain vulnerable to collateral attack for failure to satisfy the adequate representation requirement. See *id.*, at 40, 42, 61 S.Ct., at 117, 118; see also Restatement (Second) of Judgments § § 42(1)(d) and (e), Comments *e* and *f*, pp. 406, 410-412 (1982) (noting, *inter alia*, that judgment is not binding on purportedly represented person where, to the knowledge of the opposing party, the representative seeks to advance his own interest at the expense of the represented person); see also *id.*, § 41, Comment *a*, p. 394 (if § 42 circumstances exist, "the represented person may avoid being bound *either* by appearing in the action before rendition of the judgment *or* by attacking the judgment by subsequent proceedings"). (Emphasis added.) A court conducting an action cannot predetermine the res judicata effect of the judgment; that effect can be tested only in a subsequent action. See 7B C. Wright, A. Miller, & M. Kane, Federal Practice and Procedure § 1789, p. 245 (2d ed.1986).

In Delaware, the constitutional due process requirement of adequate representation is embodied in Delaware Court of Chancery's Rule 23, a class action rule modeled on its federal counterpart. *Prezant*, 636 A.2d, at 923, 920. Delaware requires, as a prerequisite to class certification, that the named plaintiffs "fairly and adequately protect the interests of the class." Del. Ch. Rule 23(a)(4). In *Prezant*, the Delaware Supreme Court considered whether adequate class representation was "a *sine qua non* for approval of a class action settlement," and concluded that it was. *Prezant*, 636 A.2d, at 920, 926. The state high court overturned a judgment and remanded a settlement because the Court of Chancery had failed to make an explicit finding of adequate representation. *Id.*, at 926.

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[5](...continued)
shares the interests of the class members).

The Delaware Supreme Court underscored that due process demands more than notice and an opportunity to opt-out; adequate representation, too, that court emphasized, is an essential ingredient. *Id.*, at 924 (citing *Phillips Petroleum Co. v. Shutts*, 472 U.S., at 812, 105 S.Ct., at 2974). Notice, the Delaware Supreme Court reasoned, cannot substitute for the thorough examination and informed negotiation an adequate representative would pursue. *Prezant*, 636 A.2d, at 924. The court also recognized that opt- out rights "are infrequently utilized and usually economically impracticable." *Ibid.*

The Vice Chancellor's evaluation of the merits of the settlement could not bridge the gap, the Delaware Supreme Court said, because an inadequate representative "taint[s]" the entire settlement process. *Id.*, at 925.[6] "[A]n adequate representative," the Delaware Supreme Court explained, "vigorously prosecuting an action without conflict and bargaining at arms-length, may present different facts and a different settlement proposal to the court than would an inadequate representative." *Ibid.* Consequently, the Delaware Supreme Court held, "*in every class action settlement*, the Court of Chancery is required to make an explicit determination on the record of the propriety of the class action according to the requisites of Rule 23(a) and (b)." *Ibid.*

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[6] In both *Prezant* and the instant case, a temporary settlement class device was used, telescoping the inquiry of adequate representation into the examination of the fairness of the settlement. According to the Delaware Supreme Court, however, this near simultaneity does *not* relieve the representative of her duty to demonstrate, nor the court of its duty to determine, the adequacy of representation. *Prezant*, 636 A.2d, at 923. In a comprehensive opinion, the Third Circuit reached the same conclusion after examining the temporary class settlement device in the context of Federal Rule of Civil Procedure 23. See *In re General Motors Corp. Pick-Up Truck Fuel Tank Products Liability Litigation*, 55 F.3d 768, 794- 800 (C.A.3 1995).

In the instant case, the Epstein plaintiffs challenge the preclusive effect of the Delaware settlement, arguing that the Vice Chancellor never in fact made the constitutionally required determination of adequate representation. See *id.*, at 923.[7] They contend that the state court left unresolved key questions: notably, did the class representatives share substantial common interests with the absent class members, and did counsel in Delaware vigorously press the interests of the class in negotiating the settlement.[8] In particular, the Epstein plaintiffs question whether the Delaware class representatives--who filed the state lawsuit on September 26, 1990, two months before the November 26 tender offer announcement--actually tendered shares in December, thereby enabling them to litigate a Rule 14d-10 claim in federal court. They also suggest that the Delaware representatives undervalued the federal claims--claims they could only settle, but never litigate, in a Delaware court. Finally, the Epstein plaintiffs contend that the Vice

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[7] The Vice Chancellor did not have the benefit of the Delaware Supreme Court's clear statement in *Prezant*, decided one year after this settlement was approved. In *Prezant*, however, the Delaware Supreme Court largely reiterated and applied what this Court had stated almost a decade earlier in *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 808, 812, 105 S.Ct. 2965, 2972, 2974, 86 L.Ed.2d 628 (1985). See also 2 R. Balotti & J. Finkelstein, Delaware Law of Corporations and Business Organization § 13.22, p. 13-131, and n. 578 (2d ed. 1996 Supp.).

[8] The order approving the class for settlement purposes, the Epstein plaintiffs urge, contains no discussion of the adequacy of the representatives, see App. 198, and the order and final judgment approving the settlement contains only boilerplate language referring to the adequacy of representation, see *id.*, at 204-205. The Delaware Supreme Court approved the Court of Chancery's judgment in a one paragraph order. See *In re MCA, Inc. Shareholders Litigation*, 633 A.2d 370 (1993) (judgment order).

Chancellor improperly shifted the burden of proof;[9] he rejected the Delaware objectors' charges of "collusion" for want of evidence while acknowledging that "suspicions [of collusion] abound." *In re MCA, Inc. Shareholders Litigation,* 1993 WL 43024, at *5.[10]

Mindful that this is a court of final review and not first view, I do not address the merits of the Epstein plaintiffs' contentions, or Matsushita's counterargument that the issue of adequate representation was resolved by full and fair litigation in the Delaware Court of Chancery.[11] These arguments remain open for airing on remand. I stress, however, the centrality of the procedural due process protection of adequate representation in class action lawsuits, emphatically including those resolved by settlement. See generally J. Coffee, Suspect Settlements in Securities Litigation, N.Y.L.J., March 28, 1991, p. 5, col. 1.

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[9] Delaware law appears to place the burden of proof on the class representatives. See 2 Balotti & Finkelstein, *supra* n. 6, § 13-17, p. 13- 121 (class representative must prove satisfaction of Del. Ch. Rule 23(a) requirements, including adequacy of representation); see also 7A C. Wright, A. Miller, & M. Kane, Federal Practice and Procedure § 1765, pp. 273-274, and n. 29 (2d ed.1986); 3B J. Moore, Moore's Federal Practice § 23.02-2 (2d ed.1995).

[10] In this regard, it is noteworthy that Matsushita did not move to dismiss the Delaware action after the Vice Chancellor, in rejecting the first proposed settlement, surveyed the state-law claims and found them insubstantial. See *In re MCA, Inc. Shareholders Litigation,* 598 A.2d, at 694 (Vice Chancellor described "the asserted state law claims" as "at best, extremely weak" and of "little or no value").

[11] Counsel for Matsushita acknowledged that relief from a judgment may be sought in Delaware pursuant to that State's counterpart to Federal Rule of Civil Procedure 60(b). See Tr. of Oral Arg. 51-52; Del. Ch. Rule 60; see also 2 Newberg & Conte, *supra* n. 4, § § 11.27, 11.63 (Federal Rule of Civil Procedure 60(b) provides an avenue to challenge the adequacy of representation in a class settlement).

United States Court of Appeals,
Ninth Circuit.

Lawrence EPSTEIN; John Linder; Jane Rockford, as trustee of the Michael J. Rockford Trust; Maurice Karlin; Ruth Karlin; Beth Ann Karlin; Bert P. Karlin, Plaintiffs-Appellants,

v.

MCA, INC.; Matsushita Acquisition Corporation; Matsushita Electric Industrial Co., LTD; Matsushita Holding Corporation; Lew Wasserman; Sidney J. Sheinberg, Defendants-Appellees.

No. 92-55675.

Argued and Submitted Sept. 4, 1996.
Decided Oct. 22, 1997.

Before: NORRIS, WIGGINS, and O'SCANNLAIN, Circuit Judges.

Opinion by Judge WILLIAM A. NORRIS; Dissent by Judge O'SCANNLAIN, Circuit Judges.

WILLIAM A. NORRIS, Circuit Judge:

This case is before us on remand from the United States Supreme Court. In *Matsushita Electric Industrial Co. v. Epstein,* 516 U.S. 367, 116 S.Ct. 873, 134 L.Ed.2d 6 (1996) ("*Matsushita* "), the Court reversed our judgment in *Epstein v. MCA, Inc.,* 50 F.3d 644 (9th Cir.1995) ("*Epstein I* "), and remanded "for proceedings consistent with this opinion." *Matsushita,* 516 U.S. at ----, 116 S.Ct. at 884.

The case is a class action brought by former MCA shareholders who surrendered their stock in response to a tender offer by Matsushita. In *Epstein I,* the named plaintiffs ("the Epstein plaintiffs") contended, *inter alia,* that Matsushita's tender offer violated the so-called "all-holder, best-price" rule of SEC Rule 14d-10[1] by paying a premium for the stock of MCA's chairman and chief executive officer, Lew Wasserman, and MCA's chief operating officer, Sidney Sheinberg.[2] The district court awarded summary judgment to the defendants, and the Epstein plaintiffs appealed.

In *Epstein I* we reversed the summary judgment for Matsushita, holding that its agreement to purchase Mr. Wasserman's stock for consideration different from what it offered other shareholders violated Rule 14d-10, *see Epstein I,* 50 F.3d at 653-57, and that there was a material issue of fact as to whether a $21-million dollar payment to Mr. Sheinberg was legitimately made as incentive compensation for past services or was a premium for his stock paid in violation of Rule 14d-10. *See id.* at 657-59. We rejected Matushita's argument that there was no private right of action under § 14(d)(7) of the Williams Act, following the decisions of the Second and Third Circuits on that

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[1] Rule 14d-10, 17 C.F.R. § 240.14d-10 (1994), is promulgated under Section 14(d)(7) of the 1968 Williams Act Amendments [hereinafter "The Williams Act"] to the Securities Exchange Act of 1934, 15 U.S.C. § 78n(d)(6)-(7) (1994) [hereinafter "The Exchange Act"].

[2] The Epstein plaintiffs also claimed that the premiums paid to Messrs. Wasserman and Sheinberg violated SEC Rule 10b-13, 17 C.F.R. § 240.10b-13 (1994). We did not consider the Rule 10b-13 claim in *Epstein I* because any relief that the Epstein plaintiffs could have obtained under Rule 10b-13 was also available under Rule 14d-10. *See Epstein I,* 50 F.3d at 648 n. 5.

point.[3] *See id.* at 649-52. We also rejected Matsushita's argument that its purchase of Mr. Wasserman's stock could not have violated Rule 14d-10 because his stock was not exchanged until one hour after Matsushita accepted the tendered MCA shares for payment. *See id.* at 654-57. We also held that the district court had abused its discretion in refusing to certify the class because "[t]he claims of every tendering shareholder turn on identical facts and law--regardless of the identity or circumstances of the particular shareholder." *Id.* at 668. Finally, we affirmed the district court's dismissal of the "aiding and abetting" claims against MCA and Messrs. Wasserman and Sheinberg personally in light of the Epstein plaintiffs' concession on the issue. *See id.* at 665 n. 29.

None of these rulings on the merits of the Rule 14d-10 claims were disturbed by the Supreme Court in *Matsushita.* The Court reversed our judgment and remanded for further proceedings solely on the basis of the first question presented in Matsushita's petition for the writ of certiorari: "Whether a federal court can withhold full faith and credit from a state court final judgment approving a class action settlement simply because the settlement released exclusively federal claims."[4] *Matsushita Electric Indus. Co. v. Epstein,* 515 U.S. 1141, 115 S.Ct. 2576, 132 L.Ed.2d 826 (1995) (granting certiorari limited to Question 1 presented by the petition for writ of certiorari);

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[3] *See Polaroid Corp. v. Disney,* 862 F.2d 987, 996 (3d Cir.1988); *Field v. Trump,* 850 F.2d 938, 946 (2d Cir.1988).

[4] The Supreme Court accepted Matsushita's statement of the question presented even though that statement mischaracterized our holding. We did not withhold full faith and credit "simply" because the Delaware judgment released exclusively federal claims. Rather, we withheld full faith and credit because the great disparity between the state and federal claims--there were no overlapping issues of fact whatsoever (*see Epstein I* at 665-66)--meant that a judgment based upon an adjudication of the state claims could have no issue preclusive effect on the federal claims.

see also Matsushita, 516 U.S. at ----, 116 S.Ct. at 884 (remand order).

On remand, the Epstein plaintiffs press anew an argument that we found unnecessary to address in *Epstein I:* that we should withhold full faith and credit from the Delaware judgment because it was entered into in violation of the due process right of the absent class members to adequate representation at all times. We now turn to that question.

I

Matsushita contends that we are barred from addressing the merits of the Epstein plaintiffs' claims of inadequate representation. Matsushita makes three arguments in support of this contention:

(1) The Supreme Court's decision in *Matsushita* did not leave the issue open on remand;

(2) The issue of the adequacy of representation was fully and fairly litigated in the Delaware Court of Chancery;

(3) The Epstein plaintiffs are estopped from raising the adequacy of their representation collaterally because they did not raise it by intervening in the Delaware proceeding.

A

In arguing that the "[t]he opinion of the Supreme Court leaves no issue open on remand," Appellees' Br. at 1, Matsushita either mischaracterizes or disregards the unambiguous statements in the record to the contrary:

1. Matsushita fails to cite the Court's order granting certiorari, which limited the question it would review to

Question 1 in Matsushita's petition. *See Matsushita Electric Industrial Co. v. Epstein,* 515 U.S. 1141, 115 S.Ct. 2576, 132 L.Ed.2d 826 (1995); *see also Matsushita,* Pet. for Cert., at i ("1. Whether a federal court can withhold full faith and credit from a state court final judgment approving a class action settlement simply because the settlement includes a release of exclusively federal claims.").

2. Matsushita fails to include the first sentence of the Court's opinion which limited the question presented precisely the way Matsushita stated it in its petition for certiorari:

> This case presents the question whether a federal court may withhold full faith and credit from a state-court judgment approving a class-action settlement simply because the settlement releases claims within the exclusive jurisdiction of the federal courts.

Matsushita, 516 U.S. at ---- - ----, 116 S.Ct. at 875-76.

3. Matsushita, although quoting various excerpts from the Court's opinion, fails to quote the following explicit statement by the Court that it did not address the due process claim:

> We need not address the due process claim [of inadequate representation] ... because it is outside the scope of the question presented in this Court. *See Yee v. Escondido,* 503 U.S. 519, 533, 112 S.Ct. 1522, 1531, 118 L.Ed.2d 153 (1992). While it is true that a respondent may defend a judgment on alternative grounds, we generally do not address arguments that were not the basis for the decision below. *See Peralta v. Heights Medical Center, Inc.,* 485

> U.S. 80, 86, 108 S.Ct. 896, 899, 99 L.Ed.2d 75 (1988).

Id. at ----, n. 5, 116 S.Ct. at 880, n. 5.

4. Matsushita also failsto cite the explicit statement in Justice Ginsburg's separate opinion that the due process question of adequate representation remained open on remand, a statement that went unchallenged by any member of the Court:

> Mindful that this is a court of final review and not first view, I do not address the merits of the Epstein plaintiffs' contentions [regarding the adequacy of representation], or Matsushita's counterargument that the issue of adequate representation was resolved by full and fair litigation in the Delaware Court of Chancery. *These arguments remain open for airing on remand.*

Id. at ----, 116 S.Ct. at 890 (Ginsburg, J., concurring in part and dissenting in part) (emphasis added).

5. Finally, in arguing that the due process question is not open on remand, Matsushita ignores its *own* assertions to the Court that the question was not before it for decision. In their brief, the Epstein plaintiffs invited the Court to address the adequacy of representation issue, notwithstanding that it was outside the scope of the sole question on which the Court had granted certiorari. *See Matsushita* Resp. Br. at 34-45. In its Reply Brief, Matsushita responded:

> A. The Ninth Circuit Opinion is Not Predicated Upon Any Due Process Issue.

> Respondents invite this Court to find constitutional infirmity in the Delaware proceedings based on alleged inadequate representation and judicial supervision. Resp. Br. at 34-45. As respondents concede, the Ninth Circuit's holding is *not* predicated on these fact-specific issues. Resp. Br. at 8. Accordingly, this Court should decline to address them.

Matsushita Reply Br. at 13.

Given this state of the record, we must agree with the Epstein plaintiffs that Matsushita's argument that the due process question is not open on remand is "inexplicable." Reply Br. at 4. Matsushita attaches no weight to the Supreme Court's clear disclaimer that "We need not address the due process claim," *Matsushita,* 516 U.S. at ----, n. 5, 116 S.Ct. at 880, n. 5., and all the other references in the record that reaffirm this disclaimer.

Instead, Matsushita attempts to get around the Court's unambiguous disclaimer. First, it seizes upon language in the Court's opinion concerning Delaware preclusion law and lifts it out of context. "State-court approval of the settlement would have the collateral effect of preventing class members from prosecuting their claims in federal court." *Matsushita,* 516 U.S. at ----, 116 S.Ct. at 879; *accord* Appellees' Br. at 12. While an accurate summary of the Supreme Court's reading of Delaware preclusion law, this passage lends no support to the argument that the Supreme Court addressed, let alone disposed of, the Epstein plaintiffs' inadequate representation claim.

Matsushita's position that the Court in *Matsushita implicitly* held that the Delaware proceeding satisfied due process reads volumes between the lines. When taken in the face of the Court's explicit announcement that it did *not* render such a

holding, we agree with the Epstein plaintiffs that it becomes nothing less than "incomprehensible." Appellants' Br. at 5.

Matsushita's second ground for arguing that adequacy of representation is not open on remand rests on the very footnote--from which it selectively excerpts-- in which the Court expressly stated that it was *not* addressing due process. Matsushita misleading quotes only the first part of the footnote, which reads as follows:

> A part [sic] from any discussion of Delaware law, respondents contend that the settlement proceeding did not satisfy due process because the class was inadequately represented.... Respondents make this claim in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class....

Id. at ----, n. 5, 116 S.Ct. at 880, n. 5 (citations omitted). Matsushita omits the very next sentence of the footnote, however, in which the Court made clear that it was not disposing of the due process claim.

> We need not address the due process claim, however, because it is outside the scope of the question presented in this Court.

Id.

Matsushita would have us believe that the Court was "winking" at us--saying that it was not doing exactly what it was doing. The only reasonable interpretation of these sentences, however, is that the Court was simply stating the claim of the Epstein

plaintiffs that their representation in the Delaware proceeding was constitutionally inadequate.

In sum, we reject Matsushita's argument that the Supreme Court did not leave the due process issue open on remand. The Court laid out an unambiguous contrary intention in its statement of the question presented and in footnote five, and no voice was raised against Justice Ginsburg's explicit statement that the issue of adequacy of representation "remain[ed] open for airing on remand." *Id.* at ----, 116 S.Ct. at 890 (Ginsburg, J., concurring in part and dissenting in part).

B

Next we address Matsushita's argument that the Delaware settlement judgment precludes the Epstein plaintiffs from "relitigating" the issue of adequacy of representation under Delaware issue preclusion law. It claims that adequacy of representation was actually litigated by objectors at the Delaware fairness hearing, and that other Delaware courts would therefore give preclusive effect to the Chancery Court's determination that representation of the absent class members was adequate. Appellees' Br. at 16-18, 21-24, 22 n. 6. Therefore, Matsushita argues, under 28 U.S.C. § 1738, we too must attach issue preclusion. *See id.* at 23.

The Epstein plaintiffs argue in response that the Delaware judgment raises no issue preclusion bar to the question of constitutional adequacy of representation. First, they contend, the objectors did not actually litigate the issue at the Delaware fairness hearing, as is required under Delaware issue preclusion law. *See* Appellants' Br. at 21-23; Reply Br. at 10. More broadly, the Epstein plaintiffs contend that individual, uncertified objectors in a class action cannot constitutionally bind absent class members on the issue of adequacy of

representation. *See id.* at 17-18. We consider each contention in turn.

1

Under Delaware law, issue preclusion attaches only when a question of fact essential to the judgment has been actually litigated and determined by a valid and final judgment. *See Messick v. Star Enterprise,* 655 A.2d 1209, 1211 (Del.1995) ("The test for applying collateral estoppel requires that (1) a question of fact essential to the judgment, (2) be litigated and (3) determined (4) by a valid and final judgment.") (internal quotations omitted) (emphasis added); *Orange Bowl Corp. v. Jones,* 1986 WL 13095, at * 2 (Del.Super.1986); *Evans v. Frank E. Basil, Inc.,* 1986 WL 3973, at * 2 (Del.Super.1986). The Delaware record shows clearly that the issue of adequacy of representation was not litigated during the settlement proceedings.

First, the notice to class members said nothing about adequacy of representation. Instead, the notice stated that the purpose of the settlement hearing was to determine "(a) the fairness, reasonableness, and adequacy *of the terms of the ... Settlement,* and (b) whether an order and final judgment should be entered approving the proposed settlement." Supplemental Record ("SR") 354 (emphasis added). Whether the class was adequately represented by the named plaintiffs or by class counsel was not an issue noticed for hearing. Thus, absent class members were not on notice that they could have objected to the adequacy of representation at the settlement hearing.

Not surprisingly, the objectors who did appear at the settlement hearing did not litigate the adequacy of their representation. Objector Marion Minton focused solely on the issue of inadequate notice. *See* SR 375. Objector Pamela Minton de Ruiz, in her memorandum to the Chancery Court, framed her

objection in terms of collusion, arguing that "[t]he second proposed settlement is collusive and should not be approved." SR 402. Likewise, the Minton objectors argued at the settlement hearing that "this two-cent settlement is collusive." SR 574. Neither of the Minton objectors focused on the much broader issue of whether representation was constitutionally adequate. *See* SR 402-09.[5] Finally, objector William A. Krupman did submit an affidavit to the Chancery Court stating that he opposed the settlement because "the purported class representatives ... had proposed a settlement that benefitted no one but their own attorneys. They did not provide adequate representation." SR 422-23. However, this single blanket statement conflating the non-constitutional question of the fairness of the settlement with the constitutional question of the adequacy of representation hardly qualifies as "actual litigation" of the constitutional issue. Indeed, in his argument at the settlement hearing, objector Krupman did not address the constitutional adequacy of the representation, but argued only that the terms of the settlement were unfair. *See* SR 589-91.

Since the issue of adequacy of representation was never actually litigated in Chancery Court, no Delaware court would attach preclusion to the issue of adequate representation of the absent class members. *See Star Enterprise,* 655 A.2d at 1211. Under § 1738, neither may we. *See, e.g., Migra v. Warren City School Dist. Bd. of Educ.*, 465 U.S. 75, 88, 104 S.Ct. 892, 899-900, 79 L.Ed.2d 56 (1984) (White, J., concurring) (collecting cases).[6]

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[5] Since the Chancery Court could have found that representation was inadequate without also finding that it was collusive, litigation of the collusion issue would not constitute "actual litigation" of adequacy of representation.

[6] It also appears that Delaware courts would not attach preclusion

(continued...)

Even if adequacy of representation had actually been litigated by objectors at the fairness hearing, and even if Delaware law would allow an individual objector to bind an absentee on the issue of adequacy of representation--however improbable that might seem--we still could not give full faith and credit to such a judgment because it would violate due process of law. As the Epstein plaintiffs aptly put it, "*[o]bjectors are objectors, not class representatives.*" Reply Br. at 17-18. Binding absentees to any part of a class action judgment "is an act of judicial power," *Epstein I,* 50 F.3d at 667, and that power can only be exercised over absentees when their interests have, in fact, been adequately represented by parties lawfully authorized to represent them. *See, e.g., Richards v. Jefferson Cty., Ala.,* 517 U.S. 793, ----, 116 S.Ct. 1761, 1766, 135 L.Ed.2d 76 (1996) ("[O]ne is not bound by a judgment *in personam* in a litigation in which he is not designated as a party ... [except, in a class action, where he] has his interests adequately represented."). It

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[6](...continued)
to the Delaware judgment because the Vice Chancellor failed to make a finding, supported by reasons and evidence on the record, that the requirements of Delaware Rule 23 were satisfied. In *Prezant v. De Angelis,* 636 A.2d 915 (Del.1994), the Delaware Supreme Court held that a Court of Chancery is required to "articulate on the record its findings regarding the satisfaction of the Rule 23 criteria and supporting reasoning" before it approves a class action settlement. *Id.* at 925. The only mention of Rule 23 that the Chancery Court ever made in this case was contained in a *pro forma* statement supported by neither reasons nor evidence in the record. *See* Chancery Court's Order and Final Judgment, at 2 ("[I]t is hereby ... determined that the plaintiffs in these Actions, as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class and that the maintenance of this action as a class action meets all the requirements of Rule 23(a) and (b)(3) of the Court of the Chancery"). While we need not decide the issue, we are doubtful that this *pro forma* recital satisfies *Prezant.*

would defy this fundamental principle of our jurisprudence to allow the due process right of absent class members to adequate representation to be litigated by random, volunteer objectors.[7]

Not surprisingly, Matsushita offers no persuasive authority in its attempt to argue against this basic principle. Some of the cases that it cites involve individual litigants, not class members. In *Durfee v. Duke,* 375 U.S. 106, 84 S.Ct. 242, 11 L.Ed.2d 186 (1963), for example--upon which Matsushita relies heavily--the Supreme Court held that an individual who has unsuccessfully challenged subject matter jurisdiction in an initial action can be precluded from raising the issue in a collateral attack on the judgment. *Durfee* was not a class action and says nothing about the rights of absent class members. Some of Matsushita's other cases pre-date *Phillips Petroleum v. Shutts,* 472 U.S. 797, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985), the controlling Supreme Court precedent on the rights of absent class members. *See infra,* Section I.C. *See, e.g., Laskey v. International Union, United Auto., Aerospace & Agric. Implement Workers (UAW),* 638 F.2d 954 (6th Cir.1981). The only case Matsushita cites that offers any help on its proposition that volunteer objectors can litigate the due process rights of absent class members is *Grimes v. Vitalink Communications,* 17 F.3d 1553 (3d Cir.1994). In *Grimes,* the Third Circuit held that objectors may litigate the due process rights of absent class members who have sufficient minimum contacts to support an exercise of personal jurisdiction over them by the forum. It reasons that, so long as an absentee has "minimum contacts" with the forum, he can be bound by the judgment without receiving *Shutts'* safeguards. *See Grimes,* 17 F.3d at 1558-59, 1560 & n. 8. There is nothing in *Shutts,* however--or in any other case--to suggest that *Shutts* offers

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[7] Absent class members are, of course, bound by a judgment on the merits of the class action issues, as for example, the fairness of the settlement.

protection only to those absentees who are beyond the *in personam* reach of the forum. Because *Grimes* conflates the requirements of *in personam* jurisdiction with the due process safeguards that *Shutts* guarantees to absent class members, we respectfully decline to follow it.

Finally, Matsushita raises the alarmist cry that it will sound the death knell to finality in class actions if individual objectors cannot bind absentees on the issue of adequate representation. *See* Appellees' Br. at 2. We of course reject this hyperbole. So does Delaware. In *Prezant v. De Angelis,* 636 A.2d 915 (Del.1994), the Delaware Supreme Court points out that prudent class action defendants can protect themselves from collateral attack. Although they cannot foreclose a subsequent collateral action absolutely, they can minimize the risk by asking for a judicial finding, supported by reasons and evidence in the record, that the plaintiffs' "due process right to adequate representation has been satisfied." *Prezant,* 636 A.2d at 925-26. Such a finding will "help insure" that judgments will be subject to collateral attack only under extraordinary circumstances like those that exist in this case. *See id.* Thus, we disagree with Matsushita that finality of settlements will come to an end if volunteer objectors are not vested with the authority to bind absentees on the issue of the adequacy of class representation.

To repeat, "[o]bjectors are objectors, not class representatives." Reply Br. at 17-18 (emphasis removed). The individual objectors who voluntarily appeared at the fairness hearing were not authorized by the absentees to represent their interests, nor were they certified by the state to do so. Their appearance at the hearing did not bind anyone but themselves to an adjudication of adequacy of representation.

C

Finally, Matsushita argues that because of the procedures used in the Delaware Chancery Court, the Epstein plaintiffs cannot bring a collateral attack on adequacy of representation. This argument comes in two parts. First, Matsushita argues, the settlement hearing provided a "full and fair opportunity" for absentees to contest the adequacy of their representation. Appellees' Br. at 25. The absentees had a duty to intervene in that hearing if they wished to protect their rights, Matsushita claims, and having failed to do so, they are estopped from bringing a collateral challenge. Second, and more broadly, Matsushita argues that the procedures Delaware had in place foreclose us from *ever* hearing a collateral challenge to adequacy of representation. Matsushita argues that we are limited to reviewing the sufficiency of the *procedures* that Delaware had in place to ensure adequate representation, rather than the adequacy of the representation itself. "[T]he Chancery Court's adherence to Rule 23 procedures satisfies the Due Process Clause as a matter of law," Matsushita continues, and an absent class member's claim on "the merits" of inadequate representation "is far outside the scope of the [collateral] review permitted by ... the case law of this Court." Appellee's Br. at 30. We agree with the Epstein plaintiffs that both of these arguments are meritless.

1

Matsushita argues that class members who wish to contest adequacy of representation must intervene during the course of the class action proceedings and do battle with their own representatives in an adversarial contest over the way they are discharging their fiduciary duties. This argument ignores the clear teaching of *Phillips Petroleum Co. v. Shutts,* 472 U.S. 797, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985), that a class member is not required to do anything during the course of a

class-action proceeding. He is free to sit it out, assured that he will be bound by the result if, but only if, the proceeding comports with the special due process requirements designed to safeguard the interests of absent class members. As the Court put it in *Shutts,* "Unlike a defendant in a normal civil suit, an absent class-action plaintiff is not required to do anything. He may sit back and allow the litigation to run its course, *content in knowing that there are safeguards provided for his protection.*" *Id.* at 810, 105 S.Ct. at 2974 (emphasis added). Those "safeguards", as enumerated in *Shutts,* are (1) "notice," (2) "an opportunity to be heard and participate in the litigation," (3) "an opportunity to remove himself from the class" by opting out, *and* (4) "adequate represent[ation]" "*at all times.*" *Id.* at 812, 105 S.Ct at 2974 (emphasis added). Thus, *Shutts* admonishes absent class members that they will be bound by the merits of a judgment--including the fairness of a court-approved settlement--if it is a product of adequate representation and their other due process safeguards. But *Shutts* promises in return that they need not monitor this proceeding from afar: if the litigation culminating in the judgment violated their due process rights, then absent class members will not be bound by it.

Gonzales v. Cassidy, 474 F.2d 67 (5th Cir.1973)--a precursor to *Shutts*-- is square authority against Matsushita's intervene-or-be-estopped argument. In *Gonzales,* the Fifth Circuit rejected the very argument that Matsushita now urges upon us: "[The defendants] advance an estoppel-type argument to support the proposition that [the absent class member] cannot raise the inadequate representation issue [on collateral review]. Their position is that [the absent class member] is estopped to attack the judgment because he should have intervened." *Id.* at 76.

In rejecting this argument and holding that an absent class member may collaterally attack a judgment on the ground that he was not adequately represented, the Fifth Circuit reasoned

that the question "whether counsel's conduct of the entire suit was such that due process would not be violated by giving res judicata effect to the judgment in that suit," *id.* at 74, "*necessarily requires a hindsight approach.*" *Id.* at 73 n. 11 (emphasis added). As the court went on to say, "The purpose of Rule 23 would be subverted by requiring a class member who learns of a pending suit involving a class of which he is a part to monitor that litigation to make certain that his interests are being protected...." *Id.* at 76.[8]

A hypothetical based on the facts of our case serves to illustrate the common sense soundness of *Shutts* and *Gonzales* and the impracticality of Matsushita's argument that the Epstein plaintiffs are now estopped from challenging the adequacy of representation because they failed to intervene at the fairness hearing. Suppose a class member did appear as an objector at the hearing and challenged the fairness of the settlement on the ground that it had not taken into account the claim that a $21-million payment to Sheinberg was in reality a premium for his stock. *See infra,* Section II.B.2. Suppose further that the objector produced evidence in the form of deposition testimony and documents--perhaps discovered in a parallel federal class action--casting doubt on the real purpose of the $21-million payment. Suppose still further that Delaware counsel had never heard of the $21-million payment before the objector reported it at the fairness hearing.

The question is: how should class counsel have responded to this new evidence about the Sheinberg payment during the

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[8] Delaware's class action provision is modeled after its federal counterpart. *Compare* Del. Chancery Court Rule 23 *with* Fed. R. Civ. Proc. 23. *See also Hoffman v. Cohen,* 538 A.2d 1096, 1098 (Del.1988) ("[T]he construction of [the Federal Rules of Civil Procedure] by the federal judiciary is of great persuasive weight in the construction of the [Delaware Rules].") (citation omitted).

middle of the fairness hearing, given their fiduciary duty to look after the interests of all members of the class? The obvious answer would seem to be to ask the Vice Chancellor to continue the fairness hearing until they had a chance to learn more about the Sheinberg payment and consider its potential settlement value. After all, if there was evidence to prove that the $21-million payment was a premium to get Mr. Sheinberg to support the tender offer, it would take only a simple calculation to determine that other shareholders would be entitled to a substantial recovery. *See infra,* Section II.B.2.

Let us suppose, however, that for whatever reason--perhaps the irresistability of a quick fee on claims they could not litigate--counsel stuck to their guns and got the proposed settlement--2 per share (less attorneys fees)--approved and cast into a judgment. Could the law possibly be that all the class members who failed to intervene at the fairness hearing are estopped from challenging the judgment collaterally on the ground that they were not provided adequate representation? Common sense as well and *Shutts* and *Gonzales* dictate that the answer must be that they are not.

This dilemma is the driving force behind *Gonzales* ' reasoning. The impracticality of assessing the adequacy of ongoing representation "live-time" is the very reason that the Fifth Circuit in *Gonzales* insisted that the challenge must be conducted with a "hindsight" approach, as on collateral review. Matsushita attempts to turn this around and limit *Gonzales* 'scope to cases in which it was "impossible to raise" the constitutional claim in the original proceeding. See Appellees' Br. at 35-26 ("*Gonzales* also turns on the impossibility of participation in the original proceeding.... *Gonzales* thus stands for the limited proposition that [collateral attack is limited to] due process violations that could not have been presented in the rendering court prior to the entry of judgment.").

This is not what *Gonzales* held. On the contrary, it held that even claims that were not "impossible" to have been raised in the initial proceedings are entirely appropriate for collateral review:

> To answer the question whether the class representatives adequately represented the class so that the judgment in the class suit will bind the absent members of the class requires a two-pronged inquiry: (1) did the trial court in the first suit correctly determine, initially, that the representative would adequately represent the class? and (2) Does it appear, after the termination of the suit, that the class representative adequately protected the interest of the class?

Gonzales, 474 F.2d at 72.

To hold otherwise--with respect to either prong of the inquiry--would be to require absent class members to monitor the proceedings in order to secure their rights to adequate representation. Absent class members are not required to bear this burden. *See Shutts,* 472 U.S. at 810, 105 S.Ct. at 2973-74; *Gonzales,* 474 F.2d at 76 ("The [adequate representation safeguard] would be subverted by requiring a class member ... to monitor the litigation...."). They may rest secure in the knowledge that they can attack the judgment in a subsequent action if their due process rights are in fact violated. "Due process of law would be violated for the judgment in a class action suit to be res judicata to the absent class members unless *the court applying res judicata* can conclude that the class was adequately represented in the first suit." *Gonzales,* 474 F.2d at 74 (citing *Hansberry v. Lee,* 311 U.S. 32, 61 S.Ct. 115, 85

L.Ed. 22 (1940)) (emphasis added).[9] Indeed, to permit such a due process challenge to be definitively resolved in the initial proceeding would effectively permit an initial court to pronounce the preclusive effect of its own judgment. *See Matsushita,* 516 U.S. at ----, 116 S.Ct. at 888 (Ginsburg, J., concurring in part and dissenting in part) ("A court conducting an action cannot predetermine the res judicata effect of the judgment; that effect can be tested only in a subsequent action.") (citing 7B *Charles A. Wright, Arthur R. Miller & Mary Kay Kane, Federal Practice and Procedure* § 1789, at 245 (2d ed.1986)).

In adopting *Gonzales* ' reasoning (and rejecting Matsushita's spin on it), we bring our circuit into line with settled law that forecloses Matsushita's intervene-or-be-estopped theory. As the Court stated in *Shutts,* "an absent class-action plaintiff is not required to do anything." *Shutts,* 472 U.S. at 810, 105 S.Ct. at 2974. Rather, it is the prerogative of absentees to remain just that: *absent* from a proceeding in which they are "parties" only virtually, through their class representatives. The "continuing solicitude for their rights" entitles absent class members to refrain from intervening, "content in knowing that there are safeguards provided for [their] protection." *Id.* at 810, 105 S.Ct. at 2974. By forcing an absent class member to monitor a proceeding and intervene to challenge the adequacy of

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[9] Matsushita offers yet another argument in its attempt to foreclose us from making this assessment. It claims that, because we are a *federal* tribunal, § 1738 forecloses us from reviewing the adequacy of the representation afforded absent class members in a *state* proceeding, even though another state court would be able to hear the claim. The Supreme Court has rejected this argument. *See Kremer v. Chemical Construction Corp.,* 456 U.S. 461, 482, 102 S.Ct. 1883, 1898, 72 L.Ed.2d 262 (1982) ("A state may not grant preclusive effect in its own courts to a constitutionally infirm judgment, and other state *and federal* courts are not required to accord full faith and credit to such a judgment.") (emphasis added) (footnote omitted).

representation that he is still in the process of receiving would defeat the purpose of having such safeguards. As Justice Ginsburg further made clear in her separate opinion in *Matsushita:* "[An absent class member] may avoid being bound *either* by appearing in the action before rendition of the judgment *or by attacking the judgment by subsequent proceedings.*" *Matsushita,* 516 U.S. at ----, 116 S.Ct. at 888 (Ginsburg, J., concurring in part and dissenting in part) (first emphasis in original, second emphasis added) (quoting Restatement (Second) of Judgments § 41, Comment a, p. 394); *see also* 18 *Charles A. Wright, Arthur R. Miller & Edward H. Cooper, Federal Practice and Procedure* § 4455, at 479 (1981) ("[Adequate representation] ordinarily is ... determin[ed] in defining any class that is certified. *The question remains open to redetermination in a subsequent action,* however, since nonparties can be bound only if some party adequately represented their interests.") (emphasis added); *Gonzales,* 474 F.2d at 76 (absent class member has no duty to monitor class action proceeding); *cf. Martin v. Wilks,* 490 U.S. 755, 762- 65, 109 S.Ct. 2180, 2184-86, 104 L.Ed.2d 835 (failure to intervene did not estop non-parties from suing parties to consent decree that adversely affected their interests).

2

Matsushita attempts to avoid *Shutts* by arguing that *Kremer v. Chemical Constr. Corp.,* 456 U.S. 461, 102 S.Ct. 1883, 72 L.Ed.2d 262 (1982) prevents absentees from ever collaterally challenging adequacy of representation when the forum state uses a procedure like Delaware Chancery Court Rule 23. This attempt gets Matsushita nowhere. We reiterate the fundamental principle that *Shutts* established: absent class members have a right to adequate representation "at all times," and they have no duty to intervene in the initial proceeding in order to protect that right. *Shutts,* 472 U.S. at 812, 105 S.Ct. at 2974-75. There is nothing in *Kremer* to the contrary.

In *Kremer,* the Court reaffirmed the bedrock principle that a judgment must satisfy the requirements of due process in order to receive full faith and credit. In the specific case before it, the Court held that a New York administrative proceeding was entitled to full faith and credit because the procedures it employed satisfied due process. Matsushita argues that *Kremer* likewise limits absent class members to a "procedures only" approach when they seek to challenge adequacy of representation. It points to passages in *Kremer* that ask whether the New York administrative proceeding provided the "minimum procedural requirements" of due process. *Kremer,* 456 U.S. at 481, 102 S.Ct. at 1897. It then argues that the mere existence of Rule 23 satisfies the "minimum procedural requirements" for protecting adequacy of representation. That being so, Matsushita concludes, *Kremer* never permits a collateral challenge that alleges that absent class members *in fact* received inadequate representation.

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We categorically reject this simplistic application of *Kremer* to the class action context. The Court fashioned *Kremer*'s "procedures only" approach to apply to collateral challenges of judgments in traditional litigation, where individual parties are bound by virtue of their *presence* before the court. *Kremer* was not a class action and did not address the special due process problems of binding persons not parties to the action. *Shutts,* in contrast, which was a class action, held that absentees have a right to adequate representation "at all times," 472 U.S. at 812, 105 S.Ct. at 2974, and that they need not intervene to enforce that right. No procedure can reliably protect an absent plaintiff who does not *in fact* have an adequate representative in court championing his cause. The Court recognized this salutary principle in *Hansberry v. Lee,* 311 U.S. 32, 61 S.Ct. 115, 85 L.Ed. 22 (1940), and it has never retreated from it. *See id.* at 41-42, 61 S.Ct. at 118 ("members of a class not present as parties to the litigation may be bound by the judgment where they are *in fact* adequately represented") (emphasis added).

Nonetheless, Matsushita argues, the absent class members in this case received notice, an opportunity to be heard (at the objection hearing), and the right to opt out of both the class action proceeding and the proposed settlement. Surely, Matsushita complains, these protections fully satisfied the "minimum procedural requirements" of *Kremer,* and due process does not require anything more.

The Supreme Court, however, could not have been more clear in requiring more. Indeed, if settled law defeats Matsushita's contention that absent class members have a duty to intervene or be estopped from challenging the adequacy of their representation, then this contention faces a veritable fortress of authority. In *Shutts,* the Court echoed the language of *Kremer* when it laid out the "minimum procedural due process protection" due to absent class members, including "adequate represent[ation]" "at all times." *Shutts,* 472 U.S. at 811-12, 105 S.Ct. at 2974. In addition to *Shutts,* the case law is consistent that adequate representation *in fact* is required to bind absent plaintiffs. *See Richards v. Jefferson Cty.,* 517 U.S. 793, ----, 116 S.Ct. 1761, 1766, 135 L.Ed.2d 76 (1996); *Matsushita,* 516 U.S. at ----, 116 S.Ct. at 885 (Ginsburg, J., concurring in part and dissenting in part); *Hansberry,* 311 U.S. at 41-43, 61 S.Ct. at 117-18; *Crawford v. Honig,* 37 F.3d 485, 487 (9th Cir.1994); *Brown v. Ticor Title Ins. Co.,* 982 F.2d 386, 390 (9th Cir.1992); *Class Plaintiffs v. City of Seattle,* 955 F.2d 1268, 1278 (9th Cir.1992); *In re Real Estate Title and Settlement Services Antitrust Litig.,* 869 F.2d 760, 769 (3d. Cir.1989); *see also* Restatement (Second) of Judgments § § 41 & 42 (1982); 18 Charles A. Wright, Arthur R. Miller, and Edward H. Cooper, Federal Practice and Procedure § 4455, at 477 (1981) ("Adequate representation [in fact] is required to support preclusion by judgment in a class action.").

None of the cases cited by Matsushita offer support for its position that absent class members who receive notice and a

chance to opt out of a settlement are foreclosed from challenging adequacy of representation. Matsushita places particular reliance upon two Ninth Circuit cases--*Torrisi v. Tucson Electric Power Co.*, 8 F.3d 1370 (9th Cir.1993), and *Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173 (9th Cir.1977). Neither of these cases speak to the rights of *absent* class members, however; they involve challenges by persons who represented themselves before the court in class action proceedings.

Torrisi involved a direct appeal of a settlement judgment by class members who chose to participate in the trial court proceedings as objectors to the settlement, rather than resting on their *Shutts* right to be represented as absentees. *See Torrisi,* 8 F.3d at 1370, 1375 n. 2 (9th Cir.1993) (noting that litigants filed objections, opposed settlement, and "participated in the settlement hearing and argued against approval of the settlement"). Thus, *Torrisi* stands for the unremarkable proposition that class members who choose to protect their interests by intervening in the trial court proceedings--instead of relying on the representation of class counsel--are bound to the resulting judgment and may not get a second bite at the apple by attacking it collaterally. *See also Matsushita,* 516 U.S. at ----, 116 S.Ct. at 888 (Ginsburg, J., concurring in part and dissenting in part) ("[T]he represented person may avoid being bound *either* by appearing in the action before rendition of judgment *or* by attacking the judgment by subsequent proceedings.").

Torrisi does not discuss or even allude to the rights of absent class members. Indeed, *Torrisi* does not even cite *Shutts,* the leading authority on the due process rights of absent class members. Faced with the task of explaining this omission, Matsushita attempts to distinguish *Shutts* from *Torrisi* on the ground that *Shutts* did not involve a settlement, but rather an adjudication of a class action. Matsushita fails to cite a single

case in support of its argument that *Shutts* ' requirement of adequate representation "at all times," *Shutts,* 472 U.S. at 812, 105 S.Ct. at 2974, may be diluted in class settlement proceedings. Nothing in *Shutts* suggests a "sub-class" of settlement class actions in which class members are only entitled to lesser due process protections, and we see no principled basis for so limiting *Shutts.* Quite to the contrary, Matsushita's argument regarding settlement class actions was rejected by the Supreme Court in *Amchem Products v. Windsor,* 521 U.S. 591, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997).

In *Amchem,* the Court reviewed a settlement class action certified in asbestos litigation. In the course of its analysis, the Court held that the safeguards designed for the protection of absent class members--including adequate representation--"demand undiluted, even heightened, attention in the settlement context." *Id.* at ----, 117 S.Ct. at 2248. As the Court explained, such heightened attention is necessary because a court that certifies a class for the purpose of settling claims rather than litigating them will "lack the opportunity, present when a case is litigated, to adjust the class, informed by the proceedings as they unfold." *Id.* at ----, 117 S.Ct. at 2248. Moreover, to collapse absentees' right of adequate representation into their right to review and opt out of the settlement would be to "substitute for Rule 23's certification criteria a standard never adopted--that if a settlement is "fair," then certification is proper." *Id.* at ----, 117 S.Ct. at 2249. "Federal courts ... lack authority" to make such a substitution. *Id. See also Prezant,* 636 A.2d at 924 (rejecting proposition that notice and opt out rights, without adequate representation, satisfy due process for settlement class actions). Matsushita's attempt to read into *Torrisi* a reduced standard of protection for absentees in settlement class actions is foreclosed by *Amchem.*

Matsushita also cites *Holiday Magic* for the proposition that notice and opt out rights may substitute for the right of absent

class members to adequate representation in a settlement class action. *Holiday Magic,* however, is inapposite for the same reason as *Torrisi:* it did not involve absent class members. As did *Torrisi, Holiday Magic* involved an appeal of a class settlement judgment by class members who appeared in the trial proceedings--in this case, as parties to the original action. *See Holiday Magic,* 550 F.2d at 1175 ("Appellants ... filed as cross-plaintiffs [below]."). In *Holiday Magic,* our court addressed and rejected the *merits* of the appellants' claim that they had been inadequately represented. *See id.* at 1176-79. It then added--in dictum, and over the objection of then-Judge Anthony Kennedy--that it did not think that individuals who had an opportunity to opt out of the settlement after receiving notice of its terms should be allowed to "play the role of spoilers for a class of more then 31,000 people" by challenging the validity of the entire settlement on grounds of inadequate representation. *Id.* at 1177; *see also Holiday Magic,* 550 F.2d at 1179-80 (Kennedy, J., concurring) (agreeing that representation was in fact adequate but rejecting suggestion of majority that opt-out rights can substitute for adequate representation). To the extent that the panel was concerned by the prospect that an uncertified class member could forcibly bind the entire class to the result of his own claim of inadequate representation, we agree, and have held that individual objectors may not bind anyone but themselves on that issue. *See supra,* Section I.B.2.[10]

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[10] In any event, *Holiday Magic* was superseded by *Shutts,* which is now the controlling authority on the rights of absent class members. To the extent that *Holiday Magic* is inconsistent with *Shutts,* we must, of course, follow the latter. *See Catli v. Catli,* 999 F.2d 1405, 1408 n. 5 (9th Cir.1993) ("Although we must ordinarily adhere to Ninth Circuit precedent, we may reexamine that precedent without the convening of an en banc panel where our precedent has been nullified by a subsequent Supreme Court decision.") (citation omitted).

All the other cases that Matsushita cites in support of its position suffer from similar problems. Many involve *individual* litigation and do not speak at all to the rights of absent class members. *See, e.g., Kremer,* 456 U.S. at 461, 102 S.Ct. at 1886-87; *Durfee v. Duke,* 375 U.S. 106, 84 S.Ct. 242, 11 L.Ed.2d 186 (1963); *Osborn v. Ashland Cty. Bd. of Alcohol, Drug Addiction & Mental Health Svcs.,* 979 F.2d 1131 (6th Cir.1992). Some are like *Torrisi*--class actions in which the collateral attack was launched by class members who appeared and represented themselves in the initial action. *See, e.g., Nottingham Partners v. Trans-Lux Corp.,* 925 F.2d 29 (1st Cir.1991); *Sandler Assoc. v. BellSouth Corp.,* 818 F.Supp. 695 (D.Del.1993), *aff'd,* 26 F.3d 123 (3d Cir.1994). And some are like *Holiday Magic*--they pre-date *Shutts,* the controlling authority on the due process rights of absent class members. *See, e.g., Laskey v. UAW,* 638 F.2d 954 (6th Cir.1981). None speaks authoritatively to the rights of absent class members who claim inadequate representation by their class fiduciaries.

In sum, neither case law nor common sense supports Matsushita's position that the mere existence of procedures like Rule 23 can foreclose an absentee from receiving his day in court on the issue of adequacy of representation. Rather, the established practice of our circuit is exemplified by *Brown v. Ticor Title.* In that case, we entertained the merits of a collateral challenge by absent class members to adequacy of representation, stating unequivocally that "if the plaintiff was not adequately represented in the prior action or there was a denial of due process, then the prior decision has no preclusive effect." *Brown v. Ticor Title Ins. Co.* at 390 (citing *Hansberry v. Lee,* 311 U.S. 32, 61 S.Ct. 115, 85 L.Ed. 22 (1940)). Matsushita simply cannot overcome the settled law that absent class members need not do anything during the course of the proceeding, "content in knowing that there are safeguards provided for [their] protection," including the requirement that

they be "adequately represented" "at all times." *Shutts*, 472 U.S. at 811-12, 105 S.Ct. at 2974-75.

II

We now turn to the merits of the adequacy of representation issue. Following the model provided by *Gonzales*, we conduct a "two-pronged inquiry," *Gonzales*, 474 F.2d at 72.[11] First, we determine whether there was a disabling conflict of interest between Delaware counsel and the MCA shareholders who tendered their shares. Second, we review the actual conduct of Delaware counsel in discharging their fiduciary duty to protect the interests of those shareholders. *See id.* at 72-77.

A

The essence of the Epstein plaintiffs' position on the claimed conflict of interest is that the Delaware settlement was the product of a one- sided bargaining process because their representatives went to the table with no credible bargaining power. Not surprisingly, Matsushita makes no serious attempt to challenge this position, relying almost exclusively on their arguments as to why we cannot reach the merits. *See* Appellees' Br. at 41-44. It is axiomatic that a plaintiff's power to negotiate a reasonable settlement derives from the threat of going to trial with a credible chance of winning. As the Supreme Court has said, permitting class-action settlements in

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[11] In *Brown v. Ticor Title Ins. Co.*, 982 F.2d 386 (9th Cir.1992), our Circuit adopted *Gonzales* ' model for conducting an analysis of adequacy of representation (although distinguishing *Gonzales* ' result), with one additional requirement. We held that, on collateral attack, "a party must show ... that the opposing party was on notice of facts making [the alleged inadequacy of the representation] apparent." *Id.* at 390-91. In this case, that requirement is easily met, as Matsushita was on notice of all the information in the record on which we base our analysis.

which class counsel are disabled from litigating the case renders:

> both class counsel and court ... disarmed. Class counsel confined to settlement negotiations could not use the threat of litigation to press for a better offer, see Coffee, Class Wars: The Dilemma of the Mass Tort Class Action, 95 Colum. L.Rev. 1343, 1379-1380 (1995), and the court would have to face a bargain proffered for its approval without the benefit of adversarial investigation, see, *e.g.*, *Kamilewicz v. Bank of Boston Corp.*, 100 F.3d 1348, 1352 (C.A.7 1996) (Easterbrook, J., dissenting from denial of rehearing en banc) (parties "may even put one over on the court, in a staged performance"), cert. denied, 520 U.S. 1204, 117 S.Ct.[sic] 1569, 137 L.Ed.2d 714 (1997).

Amchem, 521 U.S. at ---- - ----, 117 S.Ct. at 2248-49 (1997) (per Ginsburg, J.); *see also Kamilewicz*, 100 F.3d at 1352 (Easterbrook, J., joined by Posner, C.J., and Manion, Rovner, and Diane P. Wood, JJ., dissenting from denial of rehearing en banc) ("The lawyers support the settlement to get fees; the defendants support it to evade liability; the court can't vindicate the class's rights because the friendly presentation means that it lacks essential information.")."

The Delaware class plaintiffs and their counsel could not carry out a threat to litigate the federal claims in this case, and Matsushita knew it.

The inability of the class representatives to exercise any leverage on behalf of the Epstein plaintiffs was the result of three basic facts. First, they could not litigate the federal claims because Congress has said that Exchange Act claims may not

be litigated in state courts. Thus, the claims that Matsushita violated SEC Rule 14d-10 by paying premiums to Messrs. Wasserman and Sheinberg were not and could not have been pleaded in the Delaware action. Moreover, there was no discovery on those claims; indeed, the Delaware plaintiffs probably were *unable* to conduct any discovery on the federal claims because the facts relevant to those claims had no apparent relevance to the subject matter of the state law claim that the MCA directors had breached their fiduciary duties in failing to maximize shareholder value upon a change of corporate control. *See Epstein I,* 50 F.3d at 659; Del. Chancery Court Rule 26(b)(1). Finally, Matsushita would have had reason to discount the value of any settlement made with the state plaintiffs against the risk that a state court judgment releasing Exchange Act claims would not survive a collateral attack on the ground that the Delaware courts had no jurisdiction to release exclusively federal claims especially in light of the absence of any overlapping issues of fact between the state and federal claims. *See Epstein I,* 50 F.3d at 662-65.[12] Matsushita must have recognized that it would subject itself to a substantial risk by settling the federal claims in state court rather than federal court, and would have had to discount its bottom line in the state settlement negotiations accordingly. The denouement was predictable: Matsushita used its infinitely superior bargaining power vis-a-vis the state class representatives to settle the Exchange Act claims at a rock bottom price.[13]

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[12] We note that this additional factor, though instructive in giving a full picture of the relative bargaining strength of the parties in this case, is not necessary to our holding that Delaware counsel's representation of the Epstein plaintiffs was inadequate.

[13] Indeed, it would not be an exaggeration to say that the Delaware plaintiffs were kept in state court entirely at the sufferance of

(continued...)

Second, the class representatives not only lacked the bargaining power that comes with a credible threat of going to trial and winning, they also lacked the ability to make a credible threat that they could put Matsushita at risk by going to trial on the state claims and proving facts material to the federal claims that would be binding upon Matsushita through issue preclusion. Because the state and federal claims shared no common issues of material fact, a judgment on the state claims could not be used as an "offensive" estoppel in future litigation of the federal claims. *See Epstein I,* 50 F.3d at 665- 55. While the Delaware class representatives lacked the muscle to put Matsushita at risk on the federal claims, the existence of their state class action, however worthless standing alone, served to provide Matsushita with an opportunity to try to get rid of the federal claims at a bargain basement price. If the parties could get court approval of a settlement that released the federal claims, Matsushita would have at least a fair shot of using the judgment to block the federal action with a full faith and credit argument. That is, of course, exactly what Matsushita did as soon as the judgment became final. We had the Epstein plaintiffs' appeal of the district court's summary judgment under submission when

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[13](...continued)

Matsushita. As we discuss below, the Delaware Vice Chancellor, in rejecting the first settlement, determined that the state law claims were "extremely weak" and had "little or no value" because no such state cause of action existed. *See In re MCA Shareholders Litigation,* 598 A.2d 687, 694 (Del.Ch.1991); *infra,* Section II.B.2. Matsushita could have, but did not move the Chancery Court to dismiss the state action. Rather, it chose to use it as a vehicle for seeking an inexpensive release of the federal claims. *See also* 18 *Charles A. Wright, Arthur R. Miller & Edward H. Cooper, Federal Practice and Procedure* § 4470, at 526 (Supp.1997) ("In approving the settlement, the Delaware Vice Chancellor observed that the defendants seemed more bent on escaping potential liability under federal law than on avoiding state-law claims that the Vice Chancellor had earlier characterized as extremely weak.").

Matsushita notified us of the Delaware settlement judgment and argued that we should give it preclusive effect.

Third, Matsushita had a further bargaining advantage, quite apart from its knowledge that the Delaware plaintiffs could not put it at risk on the federal claims. Matsushita also knew that class counsel had an extraordinary incentive to settle and settle *quickly* because that was the *only* way they could extract a fee out of the federal claims. Class counsel could not benefit from the federal claims by going to trial for the obvious reason that the federal claims could not be litigated in state court. Moreover, the pendency of a parallel action in federal court--the *Epstein* case--meant that Delaware class counsel were at risk of being "beaten to the punch" and getting no return on the federal claims at all. Matsushita knew that it was negotiating a release of the federal claims with class counsel who could not litigate those claims and whose self-interest gave them an incentive to settle and settle fast.

What all this demonstrates is that there was a jarring misalignment of interests between class counsel and members of the federal class. It was plainly in the best interest of counsel to settle the federal claims at any price. For them, any settlement was better than no settlement because settlement was the only way they could make any money on the federal claims--indeed, given that the state claims were essentially worthless, it was the only way that Delaware counsel could get any compensation at all. Delaware counsel were not, after all, serving as *pro bono* counsel to the MCA shareholders who tendered their shares.

It was not, in contrast, in the best interest of the clients--the MCA shareholders--to settle their Exchange Act claims at any price. Their interest lay in settling those claims for a sufficient amount to make it imprudent to take the risk of litigation. That risk, of course, would have to be realistically assessed in terms

of the chances of prevailing on either or both of their claims that Matsushita had violated SEC Rules 10b-13 and 14d-10 in paying premiums to Messrs. Wasserman and Sheinberg. Indeed, the misalignment of interests and incentives between class counsel and their clients in these extraordinary circumstances was so great that it is fair to say that counsel's interests were more in line with the interests of Matsushita than those of their clients.

This was not the adequate representation of absent class members that due process requires "at all times." *Shutts,* 472 U.S. at 812, 105 S.ct. at 2974. As we have said, "An adequate representative must ... be free from economic interests that are antagonistic to the interests of the class." *Larson v. Dumke,* 900 F.2d 1363, 1367 (9th Cir.1990). The interests of Delaware counsel in this case were nothing but antagonistic to the interests of the MCA shareholders who tendered their shares. As a result of the three factors described above, which make this case extraordinary on its facts, Delaware counsel's overriding economic interest lay in settling the federal claims at any price and winning the race to judgment. The interests of the MCA shareholders who tendered their shares, in contrast, lay in pursuing those claims vigorously and either obtaining a reasonable settlement or litigating the claims in federal court. Their interests certainly did not lie in agreeing to a settlement that gave the attorneys a $1,000,000 fee but nothing for themselves--the settlement originally proposed by Delaware counsel--nor in agreeing to a settlement of 2 per share, inclusive of attorneys' fees--the settlement Delaware counsel ultimately persuaded the Vice Chancellor to approve. The inability of Delaware counsel to litigate the federal claims, their further inability even to obtain a judgment on the state law claims that could have had issue preclusive effect on the federal claims, and the pendency of a competing parallel class action in federal court caused the economic interests of Delaware counsel to be fundamentally "antagonistic to the interests" of the Epstein

plaintiffs. *Id.* As we have previously said--and as pure common sense dictates--"Adequate representation ... depends on ... an absence of antagonism." *Brown v. Ticor Title Ins. Co.,* 982 F.2d 386, 390 (9th Cir.1992). Here, there is no question that there was antagonism between the interests of the lawyers and the interests of their clients. That antagonism made their representation of the MCA shareholders who tendered their shares inadequate as a matter of law.

B

In addition to the argument that Delaware counsel had a disabling conflict ofinterest, the Epstein plaintiffs contend that the actual conduct of Delaware counsel in settling the federal claims fell far short of the representation that due process requires. Rather, they claim, Delaware counsel completely failed to investigate or develop their federal claims and basically "rolled over" during settlement negotiations, ultimately entering into a settlement that was essentially worthless except for their own fees. This course of conduct, they conclude, falls well below the level of representation that is required to bind absentees. We agree.

Adequate representation requires that counsel "vigorously and tenaciously protect[ ] the interests of the class." *Gonzales,* 474 F.2d at 75. "Vigorous" and "tenacious" protection requires, at a minimum, that counsel pursue their clients' claims, make a reasonable effort to assess the fair settlement value of those claims, and pursue a settlement that approximates that value, always taking into account the ever-present risks of litigation. The inadequacy of Delaware counsel's representation is brought into sharp focus by their vigorous *disparagement* of the federal claims throughout the course of the settlement proceedings. Indeed, Delaware counsel's representation of those claims surpassed inadequacy and sank to the level of subversion. Counsel consistently sought to convince, not only their clients,

but their adversaries and the Chancery Court itself that the federal claims had no merit. They repeatedly and summarily dismissed those claims as "frivolous" without ever conducting any discovery or any meaningful analysis of the legal issues, much less presenting the claims in a favorable light. *See* SR 171- 72. In sharp contrast, the Epstein counsel earnestly pursued those same claims in federal court, recognizing their merit and successfully demonstrating that merit in persuading this court to reverse an adverse summary judgment ruling below. This contrast makes it all the more clear that Delaware counsel's representation of the MCA shareholders who tendered their shares fails even the most minimal standards of adequacy.

1

Barely fifteen days after the Epstein counsel filed a class action in federal court on the exclusively federal claims, Delaware counsel negotiated the release of those claims. This first Delaware settlement proposed to release all claims, state and federal, arising out of the Matsushita-MCA merger, in exchange for $1 million *in attorney fees, no* monetary compensation for shareholders, and an amended poison pill provision of dubious value. *See Epstein I,* 50 F.3d at 660; SR 75-76. In its notice to the class members regarding this settlement, Delaware counsel explained that the plaintiffs in the federal action alleged that Matsushita had violated SEC Rule 14d-10 by offering Wasserman different and more valuable consideration for his shares than it offered to other tendering shareholders.[14] In recommending the settlement of those claims, counsel told their clients that "the substantial benefits the plaintiffs and the other members of the Class can expect to receive by virtue of the Settlement" outweighed "the risks, burdens and costs of

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[14] At the time of the hearing on the first settlement proposal, the Epstein plaintiffs had not yet pled the Sheinberg claim. They did so some time after the Vice Chancellor rejected the first proposed settlement.

continued litigation ... [and the] uncertainties relating to proof of the allegations contained in the various actions." SR 76. Counsel put no flesh on this bare-bones analysis. In particular, they never explained why litigation of the state law claims would put the federal claims at "risk." Moreover, the notice for the settlement hearing offered no defense of the proposition that the benefits of the settlement were "substantial" in relation to the value of the federal claims it released. Rather, the notice merely assured class members that counsel had conducted "extensive investigation of the facts and examination of the law involved," SR 76, and had concluded that the settlement was fair. It is hard to imagine what Delaware counsel meant by an "extensive investigation," since the record shows no discovery at all on the facts underlying the federal claims. Indeed, this lack of discovery is hardly surprising. As discussed above, Delaware counsel were probably disabled from developing the federal claims through traditional discovery, since discovery in state court was limited to matters relevant to the subject matter of the state claims--that the MCA directors had violated their fiduciary duty to attempt to secure a better deal than the one Matsushita offered the shareholders. *See* Del. Chancery Court Rule 26(b)(1); *supra,* Section II.A.

Indeed, the record is clear that Delaware counsel had not conducted an extensive investigation into the merits of the federal claims in order to determine their fair settlement value. Delaware counsel admitted to the Chancery Court that they had reviewed the Wasserman claim "relatively quickly" before concluding that the claim was "frivolous" and would be "a waste of our time." SR 171-72. In fact, in their cursory review, Delaware counsel simply adopted two of the defenses raised by *Matsushita* in federal court. First, Delaware counsel took Matsushita's position that claims under Rule 14d-10 should be limited to actions taken within a rigidly defined "tender offer period." SR 123-28; *see also Epstein I,* 50 F.3d at 653-54. Matsushita had claimed that this "pure timing" rule allowed it

to give additional consideration to Wasserman by timing the exchange of his stock to occur immediately after Matsushita's acceptance for payment of all other shares tendered. *See Epstein I,* 50 F.3d at 653. Delaware counsel accepted Matsushita's "pure timing" rule uncritically and used it to disparage the Wasserman claim. SR 123-28.

Second, Delaware counsel agreed with Matsushita's position that the Wasserman agreement did not violate Rule 14d-10 because Wasserman actually received "substantially less than the cash consideration received by MCA's other stockholders." SR 129. Once again, the record shows no discovery activity at all. Instead, Delaware counsel simply accepted at face value Matsushita's position that "the Wasserman deal was less valuable than that provided to the other shareholders in the form of cash." SR 185. Epstein counsel, in contrast, produced evidence and expert testimony in arguing that Wasserman's deal was structured in order to confer upon him considerable tax benefits, and that the after-tax value that Wasserman would receive was actually much greater than the value of the tender offer to the average shareholder. *See Epstein I* Appellants' Br. at 15-16, 55.

Despite the best efforts of Delaware counsel to disparage the Exchange Act claims of the absentees they were "representing," the Chancery Court rejected the first settlement because the Wasserman claim had "significant value" while the state law claims had "little or no merit." *In re MCA Shareholders Litig.*, 598 A.2d at 690. On the merits of the federal claim, the Chancery Court was far from convinced that Delaware counsel's pure timing rule controlled: "This issue has not yet been definitively addressed by the courts and therefore this

[Rule 10b-13] claim ... clearly has arguable merit." *Id.* at 695.[15] In addition, the Chancery Court refused to accept Delaware counsel's uncritical account of the value of Wasserman's deal: "Although it is claimed that the value of the consideration given to Wasserman had less value than the cash offered to the other stockholders, the true economic value of the Wasserman consideration is uncertain." *Id.* at 695.[16] In light of the "substantial merit" of the Wasserman claim, the court held that it would be unfair to release all federal claims in a settlement that offers "no real monetary benefit to the Class" but awards the attorneys $1 million in fees. *Id.* at 695-96. The court dismissed the value of the revised poison pill provision as "illusionary [sic]." *Id.* at 696.

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The record of the Delaware action shows no activity for the ten months following April 25, 1991. The case lay dormant until the district court in Los Angeles entered summary judgment on February 10, 1992.[17] *See* SR 625. During the same interval,

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[15] Matsushita offered no authority and not much reasoning in support of this hyper technical rule, while we offered reasons and contrary authority for rejecting it in a five page analysis. *See Epstein I,* 50 F.3d at 653-57.

[16] In the summary judgment proceedings in federal district court, Matsushita did not controvert the allegation in the Epstein plaintiffs' complaint that Wasserman's consideration had a greater per share value than that received by other shareholders. The Epstein plaintiffs produced evidence on this issue, *see Epstein I,* 50 F.3d at 657 n. 9, and we left the issue open for redetermination on remand, *see id.* at 657.

[17] Matsushita also exhibited a curious degree of inaction during this period. Specifically, following the Chancery Court's determination that the state claims had "little or no merit," *In re MCA,* 598 A.2d at 690, Matsushita did not take the action that would seem to have been most

(continued...)

Epstein counsel were vigorously pursuing the federal claims, as demonstrated by over ten pages of docket entries in district court. *See* SR 803-13. Eight months later, Delaware counsel agreed to settle the exclusively federal claims for the sum of $2 million--a bare 2 a share, *inclusive* of attorney fees. *See* SR 352, 356. In advocating the second settlement to the class and the Vice Chancellor, Delaware counsel continued to disparage the federal claims. They rested their disparagement primarily on the position that the district court's entry of summary judgment was "dispositive as to [the federal claims'] lack of substantial merit." SR 460. They failed to point out, however, that the Ninth Circuit affords no deference to a district court's decision on summary judgment, but reviews such determinations *de novo. See, e.g., Bagdadi v. Nazar,* 84 F.3d 1194, 1197 (9th Cir.1996). Nor did Delaware counsel make any effort to assess the likelihood of reversal by the Ninth Circuit. They merely reiterated *Matsushita*'s arguments in an effort to convince the Chancery Court once again that the federal claims were worthless. In fact, *Delaware counsel specifically urged the Chancery Court "not [to] delve into the ultimate merits of [the federal] claims upon appeal as if it were reviewing de novo the dismissal,"* but instead that it treat the district court's decision as "dispositive." SR 460.

Delaware counsel argued without explanation that it was "doubtful" that the Ninth Circuit would reverse the district court to hold either that there is a private right of action under Rules 10b-13 and Rule 14d-10, or to reject Matsushita's strict timing rule. SR 461-64. They urged the Chancery Court to give the

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[17](...continued)
advisable and move the Chancery Court to dismiss the claim. While we do not rest our holding in this case on any finding that there was collusion between Matsushita and Delaware counsel, we note the Chancery Court's comment that "suspicions abound." *In re MCA Shareholders Litigation,* 1993 WL 43024 (Del.Ch.) (Feb.16, 1993), at *5.

dismissal of the federal claims "presumptive effect." SR 553. Counsel claimed to have "reviewed the law and ... reviewed the briefs and ... looked at the findings of fact"[18] in the federal action before determining that the federal claims were "so fraught with uncertainty, that those claims are so weak, that the record in that proceedings ... is so horrendous, that the prospect of anything emerging from that case is so remote, that $2 million more than adequately compensates--much more than adequately compensates for the release of all the federal and state claims." SR 555-56.[19] Without citing any caselaw regarding private rights of action under Rule 10b-13 or Rule 14d-10, Delaware counsel reasoned that, as a general matter, the Supreme Court and the Ninth Circuit had drastically narrowed the bases upon which private rights will be implied under any statute. *See* SR 461. Based on these generalizations and their reading of Rule 10b-13 and the implementing statute of Rule 14d-10, counsel concluded that the "weight of authority" suggested that neither Rule 10b-13 nor Rule 14d-10 authorizes a private right, SR 461-62, and characterized the federal claims as "lacking in substantial merit." SR 546.

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[18] A district court does not, of course, make "findings of fact" in ruling on a summary judgment motion. Findings of fact are made on the basis of evidentiary hearings and usually involve credibility determinations, which explains why they are reviewed deferentially under the clearly erroneous standard. *See* Fed. R. Civ. Proc. 52(a). As we have said, summary judgments are reviewed *de novo* by the Ninth Circuit.

[19] Similarly, in their notice to the class members, Delaware counsel used the same boilerplate language found in the first notice of settlement, claiming that they had conducted "extensive investigation of the facts and examination of applicable law," and that they recommended settlement "after considering (i) the substantial monetary benefits that [class members] will receive pursuant to the Settlement; ... [and] (iii) the attendant risks and delays of continued litigation." SR 353. Once again, counsel did not identify the "risks" involved in litigating the state law claims, nor did they explain why the benefits of settlement were "substantial," especially in relation to the value of the federal claims. *See supra,* Section II.B.1.

Counsel's "analysis," however, disregarded two cases, from the Second and Third Circuits, that are square holdings that there is a private right of action under Rule 14d-10. *See Polaroid Corp. v. Disney,* 862 F.2d 987, 991, 997 (3d Cir.1988); *Field v. Trump,* 850 F.2d 938, 946 (2d Cir.1988). Counsel's failure to report these cases to class members and to the Vice Chancellor is even more astonishing given that they actually cited *Field* on the issue of the timing of the Wasserman transaction. For counsel not to cite *Field* on the private right of action issue, or to cite *Polaroid* at all, is inexcusable. Needless to say, Epstein counsel cited these cases to us on appeal, *see Epstein I* Appellants' Br. at 52-55, and we followed them and brought the Ninth Circuit into line with the Second and Third Circuits, finding that a private right of action does exist under Rule 14d-10. *See Epstein I,* 50 F.3d at 652.

Delaware counsel also stated without explanation that the Ninth Circuit was "unlikely" to overturn the district court's holding that the Wasserman transaction took place after the expiration of the tender offer period, or that Wasserman did not receive greater consideration for his shares than the other MCA shareholders received. *See* SR 464-67. Once again, counsel declined to mention that we would review the district court's summary judgment rulings *de novo.* As it did in the first settlement proceedings, counsel accepted without question Matsushita's self-serving valuation of the Wasserman deal, stating in a conclusory fashion that the "lack of negotiability and relative risk" of Wasserman's preferred stock "more than sufficiently outweigh whatever tax benefits Wasserman may have derived." SR 467. Without discussing whether the value of the Wasserman consideration might present a genuine issue of fact, counsel simply stated that the district court's decision regarding the timing and value of the Wasserman transaction "would seem most unlikely to be overturned on appeal." SR 465.

Finally, to cap off their disparagement of their clients' Exchange Act claims, Delaware counsel asserted generally that the federal claims should not stand in the way of settlement because "damages on the federal claims are highly uncertain." SR 468. Counsel simply ignored the obvious: that damages on the Sheinberg claim, at least, were both easily calculable and uncontested. Matsushita paid Sheinberg $21 million in addition to the $66 in cash per share of MCA stock that it paid other shareholders. When divided by the number of shares that Sheinberg tendered, this $21-million payment would equal a premium of $17.80 per share. *See Epstein I,* 50 F.3d at 657. Thus, a simple calculation of $17.80 multiplied by the total number of shares outstanding-- approximated as 78,000,000, *see* SR 556, 568-69--would yield damages of about $1.4 billion on a successful Sheinberg claim. Even so, counsel stuck to its strategy of disparaging the federal claims in their effort to get the Vice Chancellor to approve the settlement that would produce them a fee.

In fact, there is not a single mention of the $21 million-payment to Sheinberg in Delaware counsel's memoranda or arguments to the Chancery Court. *See* SR 458-70; SR 538-63; 591-99. In their representations to the court concerning the pending federal action, Delaware counsel stated only that the federal complaint "alleg[ed] that the arrangement whereby defendant Wasserman exchanged his MCA stock for preferred stock in the merged entity (1) violated SEC Rule 10b-13 ... and (2) violated SEC Rule 14d-10." SR 439-40. They did not even mention the claim on the $21 million payment that had been pleaded in the Epstein plaintiffs' amended complaint.

It is clear, however, that Delaware counsel was aware of the Sheinberg claim. Counsel described that claim, if only briefly, in their notice to the class members as "a payment to defendant Sheinberg, which defendants asserted was ... incentive compensation," SR 346, but which plaintiffs alleged was a

"covert premium ... designed to induce Sheinberg to tender his shares." *Epstein I,* 50 F.3d at 657. In contrast, Epstein counsel learned about the $21 million payment and investigated it, questioning both Wasserman and Sheinberg about it at their depositions. *See Epstein I* ER 357, Ex. V:51-53 (deposition of Wasserman), Ex. W:193-95 (deposition of Sheinberg). Their answers revealed that no MCA board documents prior to the date of the tender offer referred to any such payment to Sheinberg. *See id.*[20] Epstein counsel relied in part on this evidence to argue the existence of a genuine issue of material fact and convince this court to reverse the summary judgment on this claim. *See Epstein I,* 50 F.3d at 658; *Epstein I* Appellants Br. at 32 (citing Wasserman and Sheinberg depositions conducted by Delaware counsel). Yet, despite the $17.80 per share value of the Sheinberg claim if a trier of fact were to find that the $21 million was a premium paid to induce Sheinberg to support the tender offer and not incentive compensation for past services, Delaware counsel stood mute on the claim while urging the Vice Chancellor to approve the settlement of $2 million, or 2 per share, inclusive of attorneys fees. Once again, the conduct of Delaware counsel in the performance of their fiduciary duties was inexcusable.

In sum, the only "vigorous" and "tenacious" work, *Gonzales,* 474 F.2d at 75, that Delaware counsel performed on behalf of the Epstein plaintiffs was to convince the Chancery Court to adopt their adversary's position and view the federal claims as

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[20] Matsushita and MCA have contended that Sheinberg was entitled to incentive compensation for past services in the form of stock options, but the Epstein plaintiffs discovered that the minutes of MCA's board meetings contained no reference to any such stock options to Sheinberg prior to the time Matsushita made its tender offer. The evidence that does exist shows the payment to Sheinberg was to be made two days after Matsushita accepted the MCA shares for payment and that Matsushita approved the agreement to make the payment. *See Epstein I,* 50 F.3d at 657-59.

essentially worthless. This was not merely "inadequate" representation, it was hostile representation that served the interests of counsel in getting a fee, but did not serve the interests of the MCA shareholders in getting a settlement based upon a thorough and fair assessment of their Exchange Act claims. To bind the Epstein plaintiffs to the Delaware judgment under these circumstances would violate their due process right to have their interests adequately represented at all times.

III

The Epstein plaintiffs also contend that we may withhold full faith and credit from the Delaware judgment because the Vice Chancellor did not adequately supervise the settlement proceedings. They argue that adequacy of judicial supervision is intricately bound up with adequacy of representation and, hence, that it rises to the level of a due process requirement. *See* Appellants' Br. at 31-37. In effect, they argue that we should add adequacy of judicial supervision to the four safeguards that *Shutts* guarantees to absent class members.

The Epstein plaintiffs cite no authority for their argument, however. They merely point us to various cases, including *Epstein I,* that have spoken in general terms about the importance of the court's role in supervising a class action proceeding. *See Epstein I,* 50 F.3d at 667; *In re General Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litigation,* 55 F.3d 768, 805 (3d Cir.), *cert. denied,* 516 U.S. 824, 116 S.Ct. 88, 133 L.Ed.2d 45 (1995) (describing "fiduciary responsibility" of courts in class actions); *Prezant,* 636 A.2d at 921 (stressing "fiduciary nature of the class action"). Because we hold that the absent class members were denied due process because of inadequate representation, we need not reach this novel constitutional question.

CONCLUSION

Our decision that the Delaware judgment deprived the Epstein plaintiffs of their due process rights to adequate representation is the product of an extraordinary set of circumstances. Delaware counsel suffered from a conflict of interest: they could not litigate the Exchange Act claims of the absent class members, could not extinguish those claims by the issue preclusive effect of a judgment based upon the state claims, and were in competition with a parallel class action in federal court which threatened to destroy their chances of securing a fee. Not surprisingly, their conduct in the Delaware action reflected this disabling conflict. Delaware counsel disparaged the Exchange Act claims of their own clients at every turn--to the clients themselves, to their adversaries, and even to the Chancery Court.

These extraordinary circumstances provide a sufficient answer to Matsushita's concern that our decision will pose a grave threat to the finality of class action judgments. The reality of the matter is that it is the rare exception for representation in a class action even to approach the point where an absentee will have a colorable claim for inadequacy. The small handful of cases that have come to our attention in which absentees have successfully challenged adequacy of representation bears this observation out. The paucity of such cases is to be expected. With rare exceptions, trial judges do their jobs and certify class representatives capable of representing the interests of absent class members. And, again with rare exceptions, the class representatives (including their counsel) faithfully discharge their fiduciary duties to the class. This case presents one of those rare exceptions.

We REVERSE the judgment and REMAND for proceedings consistent with Parts I, II, III, V & VI of *Epstein I.*

O'SCANNLAIN, Circuit Judge, dissenting:

Because I wholeheartedly agree with the Supreme Court's determination that the adequacy of representation issue was fully and fairly litigated and necessarily decided in the Delaware courts, I must respectfully dissent from the opinion this court announces today. In fashioning its own version of the events as they unfolded before the Delaware courts, the majority posits that the plaintiffs' adequacy claims were neither "actually litigated" before the Chancery Court nor "finally decided" by that court. With all deference, I believe that the undisputed facts tell a different story.

I

The argument urged upon us by the Epstein plaintiffs certainly engenders sympathy and has some force. Irrespective of whether the Delaware attorneys' conduct in the state court rose to the level of constitutional deprivation, their act of referring, in a single breath, to their own clients' claims as "fraught with uncertainty," "weak," and "horrendous" suggests less than dynamic advocacy. Regrettably, however, and unlike my colleagues, I do not believe that we are in a position to pass judgment on the merits of this appeal. The very issue presented to our court for decision today--whether or not the Epstein plaintiffs received constitutionally adequate representation in the Delaware courts--has been fully and fairly litigated before a state court of competent jurisdiction and finally decided by that court. Consequently, under the FullFaith and Credit Act, 28 U.S.C. § 1738, and the policies of federalism, comity, and finality that give it life, our court is not, in my mind, free simply to revisit the issue.

I do agree with my colleagues that the Supreme Court did not conclusively resolve the due process issue before it remanded the case to us. Indeed, as our court's opinion points out, the

Supreme Court specifically disclaimed any interest in resolving the merits of the inadequacy claim. *See Matsushita Elec. Indus. Co. v. Epstein,* 516 U.S. 367, ---- n. 5, 116 S.Ct. 873, 880 n. 5, 134 L.Ed.2d 6 (1996). However, the fact that the Supreme Court chose *not* to reach the due process challenge does not inexorably lead to the conclusion that this court *may* decide the issue. Quite the contrary, after reviewing the record, the Supreme Court concluded--in three separate passages and in no uncertain terms--that the Delaware courts had *already* conclusively resolved the due process issue. First, in Part I, in which it described the procedural posture of the case, the Court stated, rather matter-of-factly, that "[a]fter argument from several objectors, *the [Chancery] Court found the class representation adequate* ...." *Id.* at ----, 116 S.Ct. at 876 (emphasis added). Several pages later, the Court reiterated its conclusion: citing the decisions of the Delaware courts approving the second MCA settlement, the Supreme Court specifically found that the Chancery Court, in accordance with Delaware Court of Chancery Rule 23, had "*determined* that the plaintiffs [,] ... as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class." *Id.* at ----, 116 S.Ct. at 880 (quoting Order and Final Judgment at 2, *In re MCA, Inc. Shareholders Litig.*, C.A. No. 11740, 1993 WL 43024 (Del.Ch. Feb. 22, 1993)) (internal quotation marks omitted) (emphasis added). Finally, in its now famous footnote five, the Court expressed its skepticism at plaintiffs' decision even to press the due process issue "*in spite of the Chancery Court's express ruling,* following argument on the issue, that the class representatives fairly and adequately protected the interests of the class." *Id.* at ---- n. 5, 116 S.Ct. at 880 n. 5 (emphasis added).

Consequently, it is scarcely debatable that in the eyes of the Supreme Court, the Epstein plaintiffs' due process challenge was presented to and rejected by the Delaware state courts. The

trouble, I suppose, is that the majority and the Supreme Court do not share the same vision.

A

In support of its "no-actual-litigation" argument, the majority first complains that, despite the fact that the form of notice sent to class members explicitly provided the rights to opt out and to object,[21] that notice "said nothing about adequacy of representation." Maj. Op. at 1240. Of course, the first, most obvious, and most decisive response to the majority's complaint is that the doctrine of collateral estoppel simply does not demand that an issue be actually *noticed for* argument, only that it be actually *litigated at* argument. *See, e.g., Messick v. Star Enter.*, 655 A.2d 1209, 1211 (Del.1995) ("The test for applying collateral estoppel requires that (1) a question of fact essential to the judgment, (2) be litigated and (3) determined (4) by a valid and final judgment." (quoting *Taylor v. State,* 402 A.2d 373, 375 (Del.1979))). Secondly, even if lack of notice were somehow independently relevant to a proper collateral estoppel analysis, the court's no-notice argument fails to account for the fact that the form of notice mailed to each of the class members detailed the precise terms of the settlement. The very terms of that settlement--so pungently characterized by the majority as "a bare 2 a share, *inclusive* of attorney fees" and a release of all claims, state and federal--are *prima facie* evidence that something was amiss. *See* Maj. Op. at 1252-53. That fact--that the settlement *on its face* raises eyebrows--was no less true on October 27, 1992, when the notice was mailed, than our court finds it today. Consequently, the Epstein plaintiffs "were

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[21] A number of the class plaintiffs exercised their procedural rights pursuant to the notice: eighteen shareholders opted out of the class, and three class members appeared in the Delaware Chancery Court to object to the settlement. *See In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43204, at *3 (Del. Ch. Feb. 16, 1993).

not forced into a position of having to predict whether their interests would be adequately represented. They could determine whether there had been adequate representation of their interests by reviewing the terms of the settlement." *Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173, 1177 (9th Cir.1977); *accord In re Four Seasons Sec. Laws Litig.*, 502 F.2d 834, 843 (10th Cir.1974). They knew that they could object in the Delaware courts to the settlement, and, by implication, to the representation that had produced the settlement; they simply declined to do so.[2]

Closer to the heart of the appropriate collateral estoppel standard, the court claims--inexplicably, in my view--that the objectors who did elect to appear at the settlement hearing did not "actually litigate" the adequacy of their representation. To the contrary, one of the objectors, William Krupman, explicitly stated (as the majority itself acknowledges) that he opposed the settlement because "the purported class representatives ... had proposed a settlement that benefitted no one but their own attorneys. *They did not provide adequate representation to the class.*" Affidavit of William A. Krupman at 2--3, *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024 (Del.Ch. Feb. 16, 1993) (emphasis added). The majority attempts to cushion the blow of Mr. Krupman's explicit statement by accusing it of "conflating the non-constitutional question of the fairness of the settlement with the constitutional question of the adequacy of representation." Maj. Op. at 1241. Its criticism, however, rings particularly hollow for one salient reason, alluded to briefly above: the court's *own* conclusion of inadequacy rests substantially on precisely the same logic, namely, that, *under the terms of the settlement,* the Delaware

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[2] I might add that the Epstein plaintiffs' counsel's candid admission to the Supreme Court that his clients stayed out of the Delaware proceedings for purely strategic reasons, *see infra* page 1259-60, is conclusive proof that any perceived notice failure was illusory.

plaintiffs' attorneys who profited so well did so at the expense of their class-member clients. *See generally* Maj. Op. at 1250-55.

The majority dismisses the arguments of another of the objectors, Pamela Minton de Ruiz, out of hand because she failed to use the magic word "inadequacy." Rather, the court notes, Minton de Ruiz "framed her objection in terms of *collusion.*" Maj. Op. at 1240 (emphasis added). The court simply brushes Minton de Ruiz's objection aside because, it complains, she did not "focus[ ] on the much broader issue of whether representation was constitutionally adequate." Maj. Op. at 1240. Formalistic labels and logic games[3] aside, however, it appears that the court has either failed to recognize *for* itself or failed to admit *to* itself that the Epstein plaintiffs bottom their inadequacy of representation argument on virtually the identical factual predicate upon which Minton de Ruiz based her "collusion" objection. For instance, the Delaware Chancery Court characterized Minton de Ruiz's argument in the following terms:

> She argues ... that the Delaware plaintiffs have colluded with the defendants to settle this action and dispose of the supposedly meritorious federal claims in exchange for an award of attorneys' fees and a de minimis benefit to the class.

In re MCA, Inc. Shareholders Litig., Civ. A. No. 11740, 1993 WL 43024, at * 3 (Del.Ch. Feb.16, 1993). When one compares Minton de Ruiz's contention with one of the plaintiffs' central arguments from their opening brief in this appeal, the perceived

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[3] The majority would have us read Minton de Ruiz's objection as if it belonged in a Venn diagram: "All collusion is inadequacy; some inadequacy is collusion...."

distinction between "inadequacy of representation" and "collusion" quickly begins to fade:

> *Delaware counsel--paid only on a contingency basis--had no incentive other than to "compromise" other litigants' substantial federal claims.* Counsel knew that, if they settled the federal claim they would get paid; if they attempted to litigate, they would get nothing. Such a one-sided incentive structure is surely a constitutionally disabling conflict of interest....

Appellants' Opening Brief at 27 (emphasis in original). And once one recognizes that even this court's *own* inadequacy holding invokes the very same attorney-client antagonism, the majority's effort to obscure substantive identity in semantic minutiae is laid bare:

> Matsushita ... knew that class counsel had an extraordinary incentive to settle and settle *quickly* because that was the *only* way they could extract a fee out of the federal claims.
>
> ....
>
> ... Indeed, the misalignment of interests and incentives between class counsel and their clients in these circumstances was so great that it is fair to say that counsel's interests were more in line with the interests of Matsushita than those of their clients.

Maj. Op. at 1250 (emphasis in original). In sum, try as it may to "label away" objector Minton de Ruiz's argument, the fact remains that a rose by any other name is still a rose: in this case, as the court's opinion amply demonstrates, the primary reason that the class representatives were alleged to have been

inadequate was the self-interested and, dare I say, *collusive,* conduct of the Delaware class attorneys.

B

In addition to holding that the inadequacy issue was not "actually litigated" in the Delaware system, this court cites *Prezant v. De Angelis,* 636 A.2d 915 (Del.1994), and suggests that the Delaware courts did not "finally determine" the question of inadequacy in a manner consistent with Delaware law. Maj. Op. at 1241 n. 6. Again, I must agree with the United States Supreme Court's assessment that the available evidence counsels otherwise. In *Prezant,* the Delaware Supreme Court announced the following holding: "[I]n every class action settlement, the Court of Chancery is required to make an explicit determination on the record of the propriety of the class action according to the requisites of Rule 23(a) and (b)," including the mandate that class representation was adequate. *Prezant,* 636 A.2d at 925. Contrary to the majority's suggestion, the Vice Chancellor in this case specifically made the "explicit determination" contemplated by *Prezant,* when he declared that "it is ... hereby determined that the plaintiffs in the Actions, as representatives of the Settlement Class, have fairly and adequately protected the interests of the Class...." Order and Final Judgment at 2, *In re MCA, Inc. Shareholders Litig.,* Civ. A. No. 11740, 1993 WL 43024 (Del.Ch. Feb. 16, 1993). His "determination," I submit, could not have been more "explicit." What is more, the Delaware Supreme Court--the *very court* that issued the *Prezant* guidelines--entertained additional argument on the inadequacy matter, and expressly and unanimously affirmed the Chancery Court's determination that the class had been adequately represented. *See In re MCA,*

Inc. Shareholders Litig., No. 126,1993, 1993 WL 385041, at *1 (Del. Sept. 21, 1993).[4]

In sum, I conclude, as did the United States Supreme Court, that the question of adequate representation (1) was actually litigated before the Delaware Chancery Court and (2) was decided by that court in a valid and final judgment. Although the plaintiffs in this action were not themselves present before the Vice Chancellor, their grievances were ably litigated through their surrogates, objectors Krupman and Minton de Ruiz. Moreover, as the settlement notice made explicit, the plaintiffs themselves were presented with a "full and fair opportunity" to participate personally in the settlement hearing if they so desired. Consequently, under long-established principles of Delaware preclusion law, I believe that the Delaware courts would give collateral estoppel effect to the Chancery Court's judgment and would forbid plaintiffs from relitigating the merits of the inadequacy issue. *See Messick v.*

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[4] The majority accuses the Delaware Chancery Court of failing properly to support its conclusion of adequacy, citing language from the *Prezant* opinion suggesting that a court should "articulate on the record its findings regarding the satisfaction of the Rule 23 criteria and supporting reasoning in order to facilitate appellate review." *Prezant*, 636 A.2d at 925. Even if I believed that the quoted language represented the holding of the Delaware Supreme Court--which I do not, *see Goodrich v. E.F. Hutton Group, Inc.*, 681 A.2d 1039, 1045 (Del.1996) (reaffirming that the "essential" requirement recognized in *Prezant* is "a judicial determination that the adequate representation requirement of Rule 23(a)(4) has been satisfied")--I believe that the Chancery Court discharged its responsibility of articulating the reasons for its holding; it found that although the objectors had alleged that the settlement was collusive, "[s]uspicion ... is not enough." *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024, at *5 (Del.Ch. Feb. 16, 1993); *see also Youngman v. Tahmoush*, 457 A.2d 376, 381 (Del.Ch.1983) (suggesting that, under Delaware law, the party challenging the adequacy of the class members' representation bears the burden of demonstrating inadequacy). That finding was specifically affirmed by the Delaware Supreme Court.

Star Enter., 655 A.2d 1209, 1211 (Del.1995); *Evans v. Frank E. Basil, Inc.*, 1986 WL 3973, at *2 (Del.Super.Ct. Mar. 20, 1986). Pursuant to the plain--and now universally acknowledged--meaning of the Full Faith and Credit Act, 28 U.S.C. § 1738, we must do the same. *See Matsushita*, 516 U.S. at ----, 116 S.Ct. at 877 ("The Act ... directs all courts to treat a state court judgment with the same respect it would receive in the courts of the rendering state."); *accord Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 380, 105 S.Ct. 1327, 1331-32, 84 L.Ed.2d 274 (1985); *Migra v. Warren City Sch. Dist.*, 465 U.S. 75, 81, 104 S.Ct. 892, 896, 79 L.Ed.2d 56 (1984); *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 481--82, 102 S.Ct. 1883, 1897-98, 72 L.Ed.2d 262 (1982); *Allen v. McCurry*, 449 U.S. 90, 96, 101 S.Ct. 411, 415-16, 66 L.Ed.2d 308 (1980).

II

As to the majority's last-gasp invocation of *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985), to deny the Delaware judgment issue preclusive effect, I most emphatically protest. The court cites *Shutts* in support of its per se rule that class settlement objectors--such as Krupman and Minton de Ruiz--may never, consistent with the Due Process Clause, finally litigate absent class plaintiffs' rights to adequate representation. *Shutts* simply cannot, in my view, bear the weight of such an extreme interpretation.[5] The concerns that impelled the *Shutts* Court's recognition of the prerogative of absent plaintiffs generally to "sit back and allow the litigation to run its course," *Shutts*, 472 U.S. at 810, 105 S.Ct. at 2974, plainly are not in play in this case.

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[5] It is certainly worthy of note, in this respect, that the majority itself recognizes that the Third Circuit's recent, post-*Shutts*, decision in *Grimes v. Vitalink Communications Corp.*, 17 F.3d 1553 (3d Cir.1994), patently rejects such view. Maj. Op. at 1242.

The *Shutts* Court was motivated by a concern for fairness to parties who, without the right to "sit back," might be forced to forfeit their claims altogether. The *Shutts* Court found that in light of financial constraints, some plaintiffs, if forced to litigate their own claims, might "have no realistic day in court." *Id.* at 809, 105 S.Ct. at 2973. However, as the following colloquy, which occurred during oral argument before the Supreme Court, makes clear, the Epstein plaintiffs (quite unlike the "absent" class plaintiffs in *Shutts*) absented themselves from the Delaware fairness hearing not for *financial* reasons, but for *tactical* reasons:

> [COURT]: What about the argument that you should have come into Delaware to make [the inadequacy of representation] objection and not stayed out of it?
>
> [COUNSEL]: ... If we stayed out ... we knew that we could make collaterally the attack on lack of adequate representation [and] due process....

Transcript of Oral Argument at 47, *Matsushita Elec. Indus. Co. v. Epstein,* 516 U.S. 367, 116 S.Ct. 873, 134 L.Ed.2d 6 (1996). What is more, the Epstein plaintiffs lost absolutely nothing by not attending the settlement hearing. As they sat idly by, content in the notion that they had preserved their right collaterally to attack the Delaware judgment, their substantive arguments were, as detailed above, simultaneously being presented by objectors Krupman and Minton de Ruiz. (Indeed, this fact very likely was known to the Epstein lawyers, in light of objector Krupman's lawyer's admission that his client's objection had originally been drafted by the attorneys representing the Epstein plaintiffs.)

The Epstein plaintiffs have managed, quite literally, to have their cake and eat it too. They now get two bites at the proverbial apple. Today, this court not only *condones* such gluttony, it *constitutionalizes* it. We are constantly reminded that "no single model of procedural fairness, let alone a particular form of procedure, is dictated by the Due Process Clause." *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 483, 102 S.Ct. 1883, 1898, 72 L.Ed.2d 262 (1982). Rather, "due process is flexible and calls for such procedural protections as the particular situation demands." *Morrissey v. Brewer*, 408 U.S. 471, 481, 92 S.Ct. 2593, 2600, 33 L.Ed.2d 484 (1972). For the court to have co-opted the salutary principle announced in *Shutts* and applied it in rote fashion to the facts of this case undermines, in my view, the very concept of due process of law.

III

The majority seeks to hush Matsushita's "alarmist cry" that the opinion announced today "will sound the death knell to finality in class actions if individual objectors cannot bind absentees on the issue of adequate representation." Maj. Op. at 1242. The court rejects Matsushita's argument as "hyperbole." Maj. Op. at 1242. To allay Matsushita's fears, the court directs its attention to the following passage in the Delaware Supreme Court's opinion in *Prezant:*

> [The approach we announce today] will serve to benefit both class members and defendants. Class members ... will ... have their interests protected by the requirement that their claims cannot be compromised without ... a judicial determination that the Rule 23 criteria have been satisfied.... Such a determination will include a finding that their due process right to adequate representation has in fact been

> satisfied. Defendants will be protected from a possible collateral attack on the validity of the settlement by a class member claiming the settlement did not meet the requirements of Rule 23. This protection will help insure that the final release sought by defendants in settlements is indeed final.

Prezant, 636 A.2d at 925--26. I sincerely doubt that the court's reassurance is of any consolation whatsoever to Matsushita or to other potential class action defendants. If anything, it is a source of consternation. Matsushita, after all, did precisely what the *Prezant* court (and now this court) instructed it to do: It asked for and got a judicial finding--an "express ruling," in the words of the United States Supreme Court--that the representation of the plaintiff class had been constitutionally adequate. Curiously, today this court tells both Matsushita and the Delaware judiciary that, alas, they did not do enough.

Because I believe that today's decision not only threatens finality, but also contravenes "the elementary principles of federalism and comity," *Growe v. Emison*, 507 U.S. 25, 35, 113 S.Ct. 1075, 1082, 122 L.Ed.2d 388 (1993), that animate the Full Faith and Credit Act, I respectfully dissent.

United States Court of Appeals,
Ninth Circuit.

Lawrence EPSTEIN; John Linder; Jane Rockford, as trustee of the Michael J. Rockford Trust; Maurice Karlin; Ruth Karlin; Beth Ann Karlin; Bert P. Karlin, Plaintiffs-Appellants,

v.

MCA, INC.; Matsushita Acquisition Corporation; Matsushita Electric Industrial Co., Ltd.; Matsushita Holding Corporation; Lew Wasserman; Sidney J. Sheinberg, Defendants-Appellees.

No. 92-55675.

Argued and Submitted Sept. 4, 1996.
Filed Oct. 22, 1997.
Petition for Rehearing Granted June 8, 1998.
Reargued and Resubmitted Aug. 21, 1998.
Opinion Withdrawn June 7, 1999.
Filed June 7, 1999.

Before: WIGGINS, O'SCANNLAIN, and THOMAS, Circuit Judges.

Opinion by Judge O'SCANNLAIN; Concurrence by Judge WIGGINS; Dissent by Judge THOMAS.

ORDER

The opinion filed on October 22, 1997, and reported at 126 F.3d 1235 (9th Cir.1997), is withdrawn, and the attached opinion filed in its place.

OPINION

O'SCANNLAIN, Circuit Judge:

We reconsider our decision in this case which is still before us on remand from the United States Supreme Court.

In 1992, the United States District Court for the Central District of California entered summary judgment against plaintiffs-appellants ("the Epstein appellants"). In *Epstein v. MCA, Inc.*, 50 F.3d 644 (9th Cir.1995) ("*Epstein I*"), we reversed the District Court, and held, among other rulings, that because it released exclusively federal claims, a Delaware state judgment was not entitled to full faith and credit. In *Matsushita Electric Industrial Co., Ltd. v. Epstein,* 516 U.S. 367, 116 S.Ct. 873, 134 L.Ed.2d 6 (1996) ("*Matsushita*"), the Supreme Court reversed our decision in *Epstein I* and remanded for proceedings consistent with its opinion. On remand we again held, in *Epstein v. MCA, Inc.*, 126 F.3d 1235 (9th Cir.1997) ("*Epstein II* "), that the Delaware state judgment was not entitled to full faith and credit. We thereafter granted defendants-appellees' ("Matsushita") petition for rehearing, and the case was reargued. We now withdraw our previous opinion, *Epstein II,* and substitute this opinion for it in all respects.

I

In 1990, Matsushita made a tender offer for (and subsequently acquired) MCA, Inc. The tender offer precipitated two lawsuits. On September 26, 1990, a Delaware class brought claims in Delaware's Chancery Court asserting that MCA's directors breached their fiduciary duties to shareholders under Delaware law by failing to maximize shareholder value upon a change in corporate control. On December 3, 1990, while the Delaware class action was pending, the Epstein appellants filed this class action in federal district court asserting that Matsushita's tender

offer violated Securities and Exchange Commission Rules 10b-3 and 14d-10 promulgated under the Securities Exchange Act of 1934 ("Exchange Act").

On April 16, 1992, after extensive proceedings, the District Court declined to certify the Epstein appellants as a class and entered summary judgment against them. *See* Second Amended Order, No. 90-6451 (C.D. Cal. filed April 16, 1992). On October 22, 1992, while the appeal of the District Court's decision was pending before us, the Delaware class action was settled. The order and final judgment of the Delaware Chancery Court approving the settlement explicitly provided for the release of the federal claims raised in this action. *See In re MCA, Inc. Shareholders Litig.*, 1993 WL 43024 (Del.Ch. Feb.16, 1993). Because the Epstein appellants were members of both the state class and the proposed federal class and did not opt out of the Delaware settlement, Matsushita argued before us on appeal that the Epstein appellants' federal claims were barred by the Delaware judgment under the Full Faith and Credit Act, 28 U.S.C. § 1738.

In *Epstein I,* we rejected Matsushita's argument, and held that the Full Faith and Credit Act did not apply because the Delaware settlement released claims exclusively within the jurisdiction of the federal courts. Addressing the merits, we reversed the district court's entry of summary judgment and denial of class certification.[1] The Supreme Court granted certiorari to decide whether this court could withhold full faith and credit from the Delaware state judgment releasing claims within the exclusive jurisdiction of the federal courts under the Exchange Act.

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[1] We affirmed the dismissal of an aiding and abetting claim that was conceded by the Epstein appellants.

The Supreme Court held that we could not, concluding that the Delaware judgment was entitled to full faith and credit because (1) under Delaware law, the Epstein appellants were bound by the Delaware class settlement releasing the federal claims, and (2) the grant of exclusive federal jurisdiction in § 27 of the Exchange Act did not partially repeal the Full Faith and Credit Act. The Supreme Court therefore reversed our decision in *Epstein I* and remanded. *See Matsushita,* 516 U.S. at 387, 116 S.Ct. 873.

On remand, a divided panel in *Epstein II* held that despite the Court's holding in *Matsushita,* the Delaware judgment was not entitled to full faith and credit because it violated due process based on the inadequacy of the class representation. The panel therefore reversed and remanded for proceedings consistent with those portions of *Epstein I* that were not reversed by the Supreme Court.

On October 24, 1997, two days after the filing of *Epstein II,* Judge Norris, the author of both *Epstein I* and *Epstein II,* resigned from this court. Matsushita filed a petition for rehearing on November 5, 1997. On January 9, 1998, Judge Thomas was drawn to replace Judge Norris and the reconstituted panel granted the petition for rehearing on June 8, 1998. Following rehearing, we now withdraw our opinion in *Epstein II* and consider anew whether the Epstein appellants are bound by the Delaware judgment.

II

The Epstein appellants assert that, despite the Supreme Court's holding in *Matsushita,* we cannot accord full faith and credit to the Delaware judgment because it violated their due process rights to adequate representation in and judicial supervision of the Delaware proceedings. We are somewhat perplexed by this contention, because *Matsushita*'s holding was explicitly and

implicitly premised upon the validity of the Delaware judgment. The Supreme Court stated in *Matsushita* that the Epstein appellant's were "bound ... by the judgment," 516 U.S. at 379, 116 S.Ct. 873, and held that the exclusively federal claims released by that judgment were not exempted from full faith and credit, *see id.* at 385-87, 116 S.Ct. 873. It should go without saying that we are not free to ignore the Court's determinations in *Matsushita* by holding that the Epstein appellants are *not* bound by the judgment.

A

In *Matsushita,* the Supreme Court commenced its analysis by quoting the Full Faith and Credit Act's mandate "that the 'judicial proceedings' of any State 'shall have the same full faith and credit in every court within the United States ... as they have by law or usage in the courts of such State ... from which they are taken.' " 516 U.S. at 373, 116 S.Ct. 873 (quoting 28 U.S.C. § 1738). Accordingly, the first step of the *Marrese* analysis employed by the Court to determine whether the Delaware judgment could bar the litigation of exclusively federal claims required the Court to "look to the law of the rendering State to ascertain the effect of the judgment." *Matsushita,* 516 U.S. at 375, 116 S.Ct. 873 (citing *Marrese v. American Academy of Orthopaedic Surgeons,* 470 U.S. 373, 381-382, 105 S.Ct. 1327, 84 L.Ed.2d 274 (1985)).

Following *Marrese*'s instructions, the Court reviewed Delaware law on the preclusive effect of settlement judgments. The Court's canvas revealed that "[t]he Delaware Supreme Court has [ ] manifested its understanding that when the Court of Chancery approves a global release of claims, its settlement judgment should preclude on-going or future federal court litigation of any released claims." *Id.* at 377, 105 S.Ct. 1327. The Court further noted that under Delaware law, a state court settlement of a class action could release or preclude claims

only where that settlement was "determined to be fair and to have met all due process requirements." *Id.* at 377-78, 105 S.Ct. 1327 (quoting *In re MCA, Inc. Shareholders Litig.*, 598 A.2d 687, 691 (Del.Ch.1991)). The Court then concluded that "a Delaware court would afford preclusive effect to the settlement judgment in this case." *Id.* at 378, 116 S.Ct. 873.

The Epstein appellants make much of this conditional language, but it merely reflects that the Court had yet to satisfy itself that the proceedings in Delaware had met all the due process requirements for binding absent class members.[2] urning to these due process requirements, the Court proceeded to march through Delaware Chancery Rule 23, which is, as the Court noted, "modeled on Federal Rule of Civil Procedure 23." *Id.* at 371, 116 S.Ct. 873.

The Court stated that:

> As required by Delaware Court of Chancery Rule 23, *see Prezant v. De Angelis,* 636 A.2d 915, 920 (1994), the Court of Chancery found, and the Delaware Supreme Court affirmed, that the settlement was "fair, reasonable and adequate and in the best interests of the ... Settlement class" and that notice to the class was "in full compliance with ... the requirements of due process." *In re MCA, Inc. Shareholders Litigation,* C.A. No. 11740, 1993 WL 43024

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[2] We further believe that the Court's conditional language here and elsewhere, *see Matsushita,* 516 U.S. at 380, 116 S.Ct. 873 (stating that "it *appears* that the settlement judgment would be res judicata under Delaware law") (emphasis added), reflects the Court's recognition that the Delaware Supreme Court is the ultimate authority on matters of Delaware law. *See, e.g., Helicopteros Nacionales de Colombia, S.A. v. Hall,* 466 U.S. 408, 413 n. 7, 104 S.Ct. 1868, 80 L.Ed.2d 404 (1984).

> (Feb. 16, 1993).... The Court of Chancery "further determined that the plaintiffs[,] ... as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class." *In re MCA, Inc. Shareholders Litigation,* supra, reprinted in App. to Pet. for Cert. 73a. *Cf. Phillips Petroleum Co.,* supra, at 812, 105 S.Ct. at 2974 (due process requires "that the named plaintiff at all times adequately represent the interests of the absent class members").

Id. at 378-79, 116 S.Ct. 873.

Having satisfied itself that the due process requirements necessary to bind absent class members were met, the Court stated its conclusion:

> Respondents do not deny that, as shareholders of MCA's common stock, they were part of the plaintiff class and that they never opted out; *they are bound, then, by the judgment.*

Id. at 379, 116 S.Ct. 873 (emphasis added). There was nothing conditional about this holding. The Court then proceeded to the second step of the *Marrese* analysis.

B

While the Court's explicit consideration in *Matsushita* of the due process requirements to bind absent class members admittedly did not include an express statement that the Delaware judgment in question did not violate due process, that conclusion was logically necessary to the Court's holding. In *Kremer v. Chemical Construction Corp.,* the Supreme Court made plain that "[a] State may not grant preclusive effect in its

own courts to a constitutionally infirm judgment, and other state and federal courts are not required to accord full faith and credit to such a judgment." 456 U.S. 461, 482, 102 S.Ct. 1883, 72 L.Ed.2d 262 (1982). Thus in *Matsushita,* any resolution of the preclusive effect to be afforded under Delaware law to the Delaware judgment necessarily entailed a determination of whether the judgment was "constitutionally infirm." If the judgment were constitutionally infirm, the judgment could not be binding under Delaware law, nor could a federal court accord it full faith and credit. The Supreme Court's holding in *Matsushita* that under Delaware law the Epstein appellants were "bound, then, by the judgment," *Matsushita,* 516 U.S. at 379, 116 S.Ct. 873, was thus necessarily premised upon the constitutional validity of the Delaware judgment.[3]

It is further worth noting that if, as the Epstein appellants contend, the Delaware judgment violated due process and was invalid, the Court would have had no reason to proceed to step two of the *Marrese* analysis. The Court stated that it would proceed to step two only "[i]f state law indicates that the particular claim or issue would be barred from litigation in a

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[3] The Epstein appellants themselves recognize and employ similar logic in their papers. Matsushita cited *Snider v. City Of Excelsior Springs, Missouri,* 154 F.3d 809 (8th Cir.1998), as supplemental authority demonstrating that the broad collateral review sought by the Epstein appellants is also precluded by the *Rooker-Feldman* doctrine. In response, the Epstein appellants asserted that the Court's decision in *Matsushita* necessarily subsumed a determination that the *Rooker-Feldman* doctrine was inapplicable and federal jurisdiction existed, because *Rooker-Feldman* limits the subject matter jurisdiction of the lower federal courts and thus must be addressed prior to any discussion of preclusion law. (*See* Plaintiffs-Appellants' Rule 28(j) Submission of Sept. 15, 1998, at 1-2.) In light of this argument, the Epstein appellants should similarly recognize that the Court's determination that they were bound by the Delaware judgment necessarily subsumed a determination that the Delaware judgment was constitutionally valid, because states cannot give preclusive effect to constitutionally infirm judgments.

court of that state." *Id.* at 375, 105 S.Ct. 1327. Delaware law would bar the federal claims at issue only if the state settlement was "determined to be fair and to have met all due process requirements." *In re MCA, Inc. Shareholders Litig.*, 598 A.2d 687, 691 (1991). Thus, if the Delaware judgment had not met all due process requirements, the question decided by *Matsushita* would not have been reached, or even presented.[4]

In fact, if the Epstein appellants' contention that the Delaware judgment is constitutionally infirm were true, *Matsushita* would be an advisory opinion. The Court's holding would have answered the purely hypothetical question of the full faith and credit to be accorded a *valid* state judgment releasing exclusively federal claims within the Exchange Act, regardless of the fact that no such valid judgment was before the Court. We will not presume that the Court violated Article III by rendering an advisory opinion. *See, e.g., Mills v. Rogers,* 457 U.S. 291, 305, 102 S.Ct. 2442, 73 L.Ed.2d 16 (1982) (declining to consider merely hypothetical issues in light of the prohibition against advisory opinions); *Flast v. Cohen,* 392 U.S. 83, 96, 88 S.Ct. 1942, 20 L.Ed.2d 947 (1968) (noting the Article III prohibition against advisory opinions).

C

The Epstein appellants assert, however, that the opinion explicitly left the validity of the judgment open, pointing to statements by Justice Ginsburg in her dissent, and by the Court

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[4] Again, this logic should be familiar to the Epstein appellants. Just as the Epstein appellants asserted that consideration of a court's jurisdiction under *Rooker-Feldman* is logically prior to consideration of preclusion law, (*see* Plaintiffs-Appellants' Rule 28(j) Submission of Sept. 15, 1998, at 1-2), consideration of the validity of a state judgment under step one of the *Marrese* analysis is logically prior to consideration under step two of whether an exception to full faith and credit exists.

in footnote five. *See Matsushita,* 516 U.S. at 379 n. 5, 116 S.Ct. 873. We are not persuaded.

The Epstein appellants rely heavily on Justice Ginsburg's statement that because "the Ninth Circuit decided the case without reaching the due process check on the full faith and credit obligation, that inquiry remains open for consideration on remand." *Id.* at 389, 116 S.Ct. 873. This belief, however, was not shared by the majority.[5] As Justice Stevens stated in his dissent, he could "join neither [the Court's determination of Delaware preclusion law] nor the Court's judgment" because he agreed with Justice Ginsburg "that the Ninth Circuit remains free to consider whether Delaware courts fully and fairly litigated the adequacy of class representation." *Id.* at 387, 116 S.Ct. 873. This statement demonstrates that the Court's determination of the preclusive effect of the judgment under Delaware law did not leave consideration of the adequacy of representation open on remand.

Justice Ginsburg similarly stated that she concurred only "to the extent that [the Court's judgment] remands the case to the Ninth Circuit," because she objected to the Court's consideration of the content of Delaware preclusion law. *Matsushita,* 516 U.S. at 388, 116 S.Ct. 873. Thus her statement that the due process issue "remains open for consideration on remand," *id.* at 389, 116 S.Ct. 873, is properly viewed as part of her dissent, and has no bearing on whether *Matsushita* 's holding was premised on the validity of the Delaware judgment.

Moreover, Justice Ginsburg dissented because she evidently believed that the Court should not have endeavored "to speak the first word on the content of Delaware preclusion law." *Id.*

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[5] Which had, as noted previously, seemingly just performed this "due process check" in considering the preclusive effect of the judgment under Delaware law.

at 388, 116 S.Ct. 873. This statement confirms that the Court did determine the content of Delaware preclusion law, which necessarily included a determination of the judgment's constitutional validity. *See Kremer,* 456 U.S. at 482, 102 S.Ct. 1883.

The Epstein appellants also rely on the Court's now famous footnote five, in which the Court declined to address the Epstein appellants' contention "that the settlement proceedings did not satisfy due process because the class was inadequately represented." *Id.* at 379 n. 5, 116 S.Ct. 873. They ignore, however, the fact that the Court's statements in footnote five were in reference to a due process challenge "[a] part [sic] from any discussion of Delaware law." *Id.* The footnote does not indicate that the Court had not considered *any* due process concerns, nor would any such reading of the footnote be tenable in the face of the Court's explicit contemplation of the due process requirements to bind absent class members under Delaware law. Nor does the footnote in any way indicate that the Delaware courts had not resolved the issue, or that this determination would not be binding upon the Epstein appellants. Instead, the footnote implies that this determination would be binding by stating that the Epstein appellants "make this claim in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class." *Id.*

Moreover, that the Court declined to address a due process "claim ... outside the scope of the question presented," *id.,* did not necessarily leave the due process issues the Epstein appellants seek to raise open on remand. While the Court may not have wished to analyze independently every due process challenge to the Delaware judgment available under *Kremer,* its statement in footnote five did not preclude the implicit resolution of such a challenge by the Court's opinion, particularly where the issue the Epstein appellants sought to

raise was necessarily intertwined with the Court's holding and discussion of other issues.

We further note that where the Court leaves an issue open on remand, it often expressly states that it has done so. *See, e.g., United States v. O'Hagan,* 521 U.S. 642, 678, 117 S.Ct. 2199, 2220, 138 L.Ed.2d 724 (1997) (stating that petitioner's "other arguments ... remain open for consideration on remand"); *United States v. Lanier,* 520 U.S. 259, 272 n. 7, 117 S.Ct. 1219, 1228 n. 7, 137 L.Ed.2d 432 (1997) ("We also leave consideration of other issues that may remain open to the Court of Appeals on remand."). Such express statements in the Court's opinions are obviously of far greater weight than a statement in dissent such as Justice Ginsburg's, and are different in kind from the *Matsushita* majority's statement in footnote five merely declining independently to address the Epstein appellants' due process claim.

III

Apart from any statements in *Matsushita* that the Epstein appellants believe explicitly left open their due process objections on remand, the Epstein appellants assert that *Phillips Petroleum Co. v. Shutts,* 472 U.S. 797, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985), and *Kremer* create a largely unfettered right to challenge collaterally the adequacy of representation in class actions.[6]

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[6] We note that Delaware law provides no basis for the collateral review that the Epstein appellants seek. As the Court stated in *Matsushita,* "a Delaware court would afford preclusive effect to the settlement judgment in this case." 516 U.S. at 378, 116 S.Ct. 873. The Delaware Supreme Court has explained that under Delaware law: Class members ... will, in all cases, have their interests protected by the requirement that their claims cannot be compromised without ... a judicial determination that the Rule 23 criteria

(continued...)

A

Shutts does not support the broad collateral review that the Epstein appellants seek. In *Shutts,* the Court identified various procedural safeguards that are necessary to bind absent class members, including notice, the opportunity to be heard, the opportunity to opt out, and adequate representation. 472 U.S. at 812, 105 S.Ct. 2965. However, nowhere in *Shutts* did the Court state or imply that where the certifying court makes a determination of the adequacy of representation in accord with *Shutts,* this determination is subject to collateral review. *Shutts* in fact implies that such review is unwarranted by emphasizing that the certifying court is charged with protecting the interests of the absent class members. *See id.* at 809, 105 S.Ct. 2965.

Simply put, the absent class members' due process right to adequate representation is protected not by collateral review, but by the certifying court initially, and thereafter by appeal within the state system and by direct review in the United States Supreme Court. *See, e.g., Grimes v. Vitalink Communications Corp.,* 17 F.3d 1553, 1558 (3rd Cir.1994) (refusing to allow absent class members collaterally to challenge adequacy of representation because the opportunity to challenge that

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[6](...continued)

have been satisfied.... *Defendants will be protected from a possible collateral attack on the validity of the settlement by a class member claiming the settlement did not meet the requirements of Rule 23.* This protection will help insure that the final release sought by defendants in settlements is indeed final. *Prezant,* 636 A.2d at 925-26 (emphasis added).

As noted by the Court in *Matsushita,* the Delaware Chancery Court made the requisite findings, *see* 516 U.S. at 378-79, 116 S.Ct. 873, thus under *Prezant,* Matsushita is protected from a collateral attack on the validity of the settlement. *See also Hynson v. Drummond Coal Co., Inc.,* 1997 WL 741507, *1-2 (Del.Ch. Nov.24, 1997) (rejecting class members' attempt to collaterally attack a Delaware judgment on due process grounds under *Shutts*).

determination by appeal to Delaware Supreme Court, and thereafter to the United States Supreme Court, "granted all the process that was due"); *Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29, 33 (1st Cir.1991) (holding that so long as procedural safeguards were employed, objections to the determinations of a certifying court had to be remedied on appeal to the state supreme court or the United States Supreme Court, and not by recourse to the "federal courts in the vain pursuit of back- door relief").

As the Court stated in *Hansberry v. Lee,* "there has been a failure of due process only in those cases where it cannot be said that *the procedure adopted,* fairly insures the protection of the interests of absent parties who are to be bound by it." 311 U.S. 32, 42, 61 S.Ct. 115, 85 L.Ed. 22 (1940) (emphasis added). Due process requires that an absent class member's right to adequate representation be protected by the adoption of the appropriate procedures by the certifying court and by the courts that review its determinations; due process does not require collateral second-guessing of those determinations and that review.

B

Kremer does not indicate otherwise. As we have noted previously, *Kremer* held that neither state nor federal courts are required to give full faith and credit to a constitutionally infirm judgment. *See Kremer,* 456 U.S. at 482, 102 S.Ct. 1883. The extent of collateral review is, however, limited.

Kremer merely recognized that a judgment is not entitled to full faith and credit "if there is reason to doubt the quality, extensiveness, or fairness of *procedures* followed in prior litigation." *Id.* at 481, 102 S.Ct. 1883 (quoting *Montana v. United States,* 440 U.S. 147, 164 n. 11, 99 S.Ct. 970, 59 L.Ed.2d 210 (1979)) (emphasis added). Limited collateral

review would be appropriate, therefore, to consider whether the procedures in the prior litigation afforded the party against whom the earlier judgment is asserted a "full and fair opportunity" to litigate the claim or issue. *Id.* at 480, 102 S.Ct. 1883. This review would not, however, include reconsideration of the merits of the claim or issue, *see id.* at 483-85, 102 S.Ct. 1883 (declining to reexamine the facts underlying or the merits of Kremer's claim, and instead examining the procedures provided), and such a challenge would most likely fail because "state proceedings need do no more than satisfy the minimum procedural requirements of the Fourteenth Amendment's Due Process Clause in order to qualify for the full faith and credit guaranteed by federal law." *Id.* at 481, 102 S.Ct. 1883.

C

Matsushita itself indicates that broad collateral review of the adequacy of representation (or of the other due process requirements for binding absent class members) is not available. *Matsushita* made plain that class action judgments are accorded full faith and credit like other judgments:

> That the judgment at issue is the result of a class action, rather than a suit brought by an individual, does not undermine the initial applicability of § 1738. The judgment of a state court in a class action is plainly the product of a "judicial proceeding" within the meaning of § 1738. Therefore, a judgment entered in a class action, like any other judgment entered in a state judicial proceeding, is presumptively entitled to full faith and credit under the express terms of the Act.

Matsushita, 516 U.S. at 373-74, 116 S.Ct. 873 (citations omitted).

The Court did, of course, address the additional due process requirements for binding absent class members, stating, by way of example, that "due process for class action plaintiffs requires 'notice plus an opportunity to be heard and participate in the litigation,' " and " 'that the named plaintiff at all times adequately represent the interests of the absent class members.' " *Id.* at 378-79, 116 S.Ct. 873 (quoting *Shutts,* 472 U.S. at 812, 105 S.Ct. 2965). The Court, however, satisfied itself that these requirements had been met *by referencing the Delaware courts' findings on these matters,* rather than by independently determining whether the requirements were met. *See id.*[7]

After this analysis, the Court stated the seemingly uncontroversial proposition that:

> Under Delaware Rule 23, as under Federal Rule of Civil Procedure 23, "[a]ll members of the class, whether of a plaintiff or a defendant class, are bound by the judgment entered in the action unless, in a Rule 23(b)(3) action, they make a timely election for exclusion." 2 H. Newberg, *Class Actions* § 2755, p. 1224 (1977).

Id. at 379, 116 S.Ct. 873. The Court also cited *Cooper v. Federal Reserve Bank of Richmond* for the proposition that "[t]here is of course no dispute that under elementary principles of prior adjudication a judgment in a properly entertained class action is binding on class members in any subsequent litigation." 467 U.S. 867, 874, 104 S.Ct. 2794, 81 L.Ed.2d 718 (1984).

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[7] We further note that the Court's citation of *Shutts,* immediately after referencing the findings of the Delaware courts' regarding the due process requirements, belies the Epstein appellants' assertion that *Shutts* supports collateral review of these determinations.

The Court's statements in no way imply that a class member who fails to opt out is not bound until collateral review of the adequacy of representation reveals that due process has been satisfied. Nor is there any indication that a "properly entertained" class action is other than one in which a certifying court employs the appropriate procedures to determine that the due process requirements embodied in Rule 23 have been met. Any such implication would be belied by the Court's analysis of the issue because these statements followed on the heels of the Court's review of the Delaware courts' determinations that the Rule 23 requirements were satisfied.

Even footnote five, so heavily relied upon by the Epstein appellants, makes the same point. There, the Court specifically noted that the Epstein appellants sought to challenge collaterally the adequacy of representation "in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class." *Matsushita,* 516 U.S. at 379 n. 5, 116 S.Ct. 873. The Court then cited *Prezant v. De Angelis* for the proposition that the "constitutional requirement [of adequacy of representation] is embodied in [Delaware] Rule 23(a)(4)." *Id.* (alterations in the original). These statements indicated that the Epstein appellants' challenge to the adequacy of representation in the Delaware proceedings was answered by specific reference to the findings made on the issue in those proceedings.

IV

For the foregoing reasons, the Delaware judgment was not constitutionally infirm and must be accorded full faith and credit. The district court's decision of April 16, 1992 is

AFFIRMED.

WIGGINS, Circuit Judge, concurring:

I concur in the result of Judge O'Scannlain's majority opinion. I write separately to explain why I changed my vote in this appeal.

The long history of this case evinces the complexity of the issues involved. In our original disposition, we found that the Delaware judgment was not a bar to further prosecution of the federal action under the Full Faith and Credit Act, 28 U.S.C. § 1738. *See Epstein v. MCA, Inc.*, 50 F.3d 644 (9th Cir.1995). The Supreme Court reversed, concluding that the Delaware judgment was entitled to full faith and credit even if it released claims within the exclusive jurisdiction of the federal courts. *See Matsushita Elec. Indus. Co., Ltd. v. Epstein*, 516 U.S. 367, 116 S.Ct. 873, 134 L.Ed.2d 6 (1996)("*Matsushita* "). Following remand, we were presented with the issue that is the subject of this appeal.

After our initial consideration of this appeal, I joined Judge Norris' well-written opinion. *See Epstein v. MCA, Inc.*, 126 F.3d 1235 (9th Cir.1997). We found that the adequacy of representation issue was left open by the Supreme Court and was not fully and fairly litigated in state court. *See id.* at 1237-48. Proceeding to the merits of the adequacy of representation issue, the opinion convincingly concluded that Delaware counsel provided inadequate representation: "This was not merely 'inadequate' representation, it was hostile representation that served the interests of counsel in getting a fee, but did not serve the interests of the MCA shareholders in getting a settlement based upon a thorough and fair assessment of their Exchange Act claims." *Id.* at 1255.

I remain troubled by the substance of the Delaware settlement. Soon after the opinion was filed, however, I began to have grave doubts about the conclusion that the adequacy of

representation issue was not fully and fairly litigated in the Delaware courts. It is this issue that led me to change my vote.

I now believe that, while the Supreme Court did not conclusively resolve the due process issue before the remand, it did send unmistakable signals on that very issue. In three separate passages, the Court indicated that the Delaware courts likely had already conclusively resolved the due process issue.[1] Our original majority disposition in this appeal did not give sufficient weight to these admonitions.

The Supreme Court's conclusion is clearly supported by the record. One of the objectors, William Krupman, explicitly opposed the proposed settlement because "the purported class representatives ... had proposed a settlement that benefitted no one but their own attorneys. *They did not provide adequate representation to the class.*" Affidavit of William A Krupman at 2-3, *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024 (Del.Ch. Feb.16, 1993) (emphasis added). In considering Krupman's objection, the Chancery Court felt that his objection concerning the adequacy of the class representatives' representation of the class members was similar

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[1] First, in Part I of it opinion, as it described the procedural posture of the case it stated that "[a]fter argument from several objectors, the [Chancery] court found the class representation adequate...." *Matsushita*, 516 U.S. at 371, 116 S.Ct. 873. Later, in explaining why it believed that the Delaware courts would afford preclusive effect to the settlement judgment, the Supreme Court explained that "[t]he Court of Chancery 'further determined that the plaintiffs[,] ... as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class.' " *Id.* at 378, 116 S.Ct. 873 (quoting Order and Final Judgment at 2, *In re MCA, Inc. Shareholders Litigation*, Civ. A. No. 11740, [illegible]93 WL 43024 (Del.Ch. Feb.16, 1993))(internal quotation marks omitted). Finally, the Court expressed its astonishment at plaintiffs' decision to assert their due process claim "in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class." *Id.* at 379 n. 5, 116 S.Ct. 873.

to the objection raised by another objector, Pamela Minton de Ruiz, who objected to the settlement "on the basis that the settlement is collusive." *In re MCA, Inc. Shareholders Litig.* 1993 WL 43024 *3. The Chancery Court nonetheless approved the settlement because the settlement was "in the best interest of the class," notwithstanding these objections to the adequacy of the class representatives' representation. *Id.*

Because the adequacy of representation issue was fully and fairly litigated and necessarily decided in the Chancery Court, the Delaware courts would give preclusive effect to that determination. *See Messick v. Star Enter.*, 655 A.2d 1209, 1211 (Del.1995). The Full Faith and Credit Act, 28 U.S.C. § 1738, requires that we "treat a state court judgment with the same respect that it would receive in the courts of the rendering state." *Matsushita,* 516 U.S. at 373, 116 S.Ct. 873. As such, we are required to give preclusive effect to the Chancery Court's judgment that class representation was adequate irrespective of whether we agree with that determination. I therefore concur.

THOMAS, Circuit Judge, dissenting:

Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997) heralded a new era of judicial scrutiny of class action certification and settlement. The majority opinion marks a significant retreat from that philosophy, sanctioning a class settlement obtained without any record evidence that the class representatives were even members of the class. Because the Delaware judgment extinguished the rights of absent class members without affording them due process of law, I respectfully dissent.[1]

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[1] Insofar as is possible, I shall not repeat Judge Norris's forceful

(continued...)

I

Before hedging its bet by reaching the merits, the majority first concludes that we are precluded from deciding the due process questions presented to us because the Supreme Court has already done so. The opening passage of *Matsushita Electric Industrial Co., Ltd. v. Epstein,* 516 U.S. 367, 116 S.Ct. 873, 134 L.Ed.2d 6 (1996) belies this:

> This case presents a question whether a federal court may withhold full faith and credit from a state-court judgment approving a class-action settlement simply because the settlement releases claims within the exclusive jurisdiction of the federal courts.

Id. at 369, 116 S.Ct. 873.

The Court further explained:

> We need not address the due process claim [of inadequate representation] ... because it is outside the scope of the question presented in this Court. *See Yee v. Escondido,* 503 U.S. 519, 533, 112 S.Ct. 1522, 118 L.Ed.2d 153 (1992). While it is true that a respondent may defend a judgment on alternative grounds, we generally do not address arguments that were not the basis for the decision below. *See Peralta v. Heights*

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[1](...continued)
analysis, as detailed in the panel opinion on remand. *See Epstein v. MCA, Inc.,* 126 F.3d 1235 (9th Cir.1997). It demands an independent and careful examination and is, in my view, dispositive.

> *Medical Center,* Inc. 485 U.S. 80, 86, 108 S.Ct. 896, 99 L.Ed.2d 75 (1988).

Id. at 379 n. 5, 116 S.Ct. 873 (1996).

If the majority's recognition of the scope of its holding were not already plain, Justice Ginsburg's partial concurrence makes it pellucid:

> Although the Ninth Circuit decided the case without reaching the due process check on the full faith and credit obligation, that inquiry remains open for consideration on remand.

Id. at 389, 116 S.Ct. 873.

The nuances that the majority strains to draw from the opinion simply cannot bear the weight placed on them. There is nothing in the opinion that relieves us of our responsibility to examine the merits of the due process argument fully and fairly. Indeed, if any unmistakable signal were sent by the opinion, it was to do just that.

II

Judgments binding absent litigants in class action suits are an exception to the general rule that one is not bound by a judgment in personam in a litigation to which he or she is not a party. *See Hansberry v. Lee,* 311 U.S. 32, 40-41, 61 S.Ct. 115, 85 L.Ed. 22 (1940). Absent class members may be bound by the judgment if they have, in fact, been adequately represented by parties who are present. *Id.* at 42-43, 61 S.Ct. 115. Due process requires that the procedure employed to reach a binding judgment "fairly insures the protection of the interests of absent parties who are to be bound by it." *Id.* at 42, 61 S.Ct. 115.

This is, in the words of the *Hansberry* court almost sixty years ago, a "familiar doctrine." *Id.* Yet its import seems lost in this case. In order for absent class members to have "adequate representation" within the meaning of the Due Process Clause, the class must be free of structural conflict. Although analyzed in the context of Fed.R.Civ.P. 23, this proposition was central to the seminal analysis in *Amchem.* 521 U.S. at 625-28, 117 S.Ct. 2231. In a class settlement, there must be "structural assurance of fair and adequate representation for the diverse groups and individuals affected." *Id.* at 627, 117 S.Ct. 2231. The class representative "must possess the same interest and suffer the same injury shared by all members of the class he represents." *Schlesinger v. Reservists Committee to Stop the War,* 418 U.S. 208, 216, 94 S.Ct. 2925, 41 L.Ed.2d 706 (1974).

In the case at hand, there were three different types of shareholders who were part of the class: (a) those who traded on the open market; (b) those who tendered their shares; and (c) those who received spin-off shares. In addition, there were differences among the class members as to the legal theories available. The interests of the Epstein plaintiffs in advancing the federal claims were directly antagonistic to those of the Delaware class representatives, who were precluded by federal securities law from asserting those claims in state court. By the time settlement occurred, the statute of limitations prevented the Delaware class from litigating the federal claims in any court. Thus, there were irreconcilable differences in claims and damages among the class members. These structural conflicts should have actuated an inquiry by the Delaware Vice-Chancellor, and should have resulted in the creation of sub-classes to assure the adequate representation of absent class members.

The conflict prior to settlement approval was palpable. Because they could not assert federal causes of action, those claims were of no value to the class representatives and their counsel except

as a bargaining chip to enhance the value of their state claims. Indeed, settlement of the federal action was the only method by which the Delaware class could receive any money from the federal claims. Thus, it was plainly in the best interest of class representatives to settle the federal claims at any price. Class representatives had absolutely no incentive to obtain fair valuation of the federal claims, because of their inability to assert the claims.

The divergence of class interests quickly manifested itself. While Delaware counsel was admitting to the Chancery Court that they had reviewed the Wasserman claim "relatively quickly" and in the complete absence of discovery, before concluding that the claim was "frivolous," the MCA shareholders were extensively litigating that very claim in federal district court in this Circuit. And while the Delaware counsel was arguing before the Chancery Court that the Ninth Circuit was "unlikely" to overturn the district court's dismissal of the Wasserman claim, the MCA shareholders were in the process of successfully appealing that decision before this court. In addition to the inadequate representation of the Wasserman issue, it is also noteworthy that there is not a single mention of the $21 million payment to Sheinberg in the Delaware counsel's memoranda or arguments to the Chancery Court, although it is clear that Delaware counsel was aware of this claim, which had a potential value of $17.80 per share.

"[A]dequate representation ... depends on ... an absence of antagonism." *Brown v. Ticor Title Insurance Co.*, 982 F.2d 386, 390 (9th Cir.1992). In this case, the antagonistic interests, injury and claims among the class members resulted in significant structural conflicts. Because these conflicts were unresolved, the class representation was constitutionally infirm and cannot bind absent class members.

In addition, the actual representation provided by Delaware class counsel was inadequate for reasons persuasively detailed in Judge Norris's opinion on remand. *See Epstein,* 126 F.3d at 1251-55. Class counsel did not investigate or properly evaluate the federal claims. Class counsel provided a misleading and incorrect analysis of the claims to the Chancery Court. The interests of the Epstein plaintiffs were not represented adequately by class counsel; indeed, their interests were undermined by the antagonistic strategy of class counsel.

Finally, there is no record evidence that the class representatives were even members of the putative class. A non-waivable prerequisite to approval of a class settlement binding absent class members is that the class representative be a member of the class. *See East Texas Motor Freight System, Inc. v. Rodriguez,* 431 U.S. 395, 403, 97 S.Ct. 1891, 52 L.Ed.2d 453 (1977) ("As this Court has repeatedly held, a class representative must be part of the class...."). The best argument that the class representatives could offer was that such an allegation was contained in the complaint, that there were a large number of law firms involved and that the settlement was accepted by class members.[2] None of this, of course, comes

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[2] The class representatives did not reply to this charge in their briefs. At oral argument, the following colloquy occurred:

Question: Where is there evidence in the record that any of the named representatives were actually members of the class?

Answer: In the Delaware proceeding, there were twelve different class representatives, represented by twenty different law firms and all of them were possessed of the state and federal claims that were resolved in the Delaware action.

Question: Is your answer basically that there is nothing of evidence in the record, but everyone was on notice and you are relying on that?

Answer: I'm certainly relying on the fact that a notice went to every single class member outlining the settlement, the pendency of the

(continued...)

close to being record evidence. This explanation can be credited only if one believes that representational adequacy or adherence to procedural due process may be established by circumstantial evidence.

The majority decision correctly observes that *Phillips Petroleum Co. v. Shutts,* 472 U.S. 797, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985), enumerated "various procedural safeguards that are necessary to bind absent class members." In fact, *Shutts* specifically indicates that "the Due Process Clause of course requires that the named plaintiff at all times adequately represents the interests of the absent class members." 472 U.S. at 812, 105 S.Ct. 2965 (*citing Hansberry v. Lee,* 311 U.S. 32, 42-43, 61 S.Ct. 115, 85 L.Ed. 22 (1940)). The litigation leading up to the Delaware settlement thus violated the "minimal procedural due process protection" due to the Epstein plaintiffs: adequate representation "at all times."

> "[I]f the plaintiff was not adequately represented in the prior action, or there was a denial of due process, then the prior decision has no preclusive effect." *Brown,* 982 F.2d at 386. Thus, the Epstein plaintiffs are entitled as a matter of federal law to assert their claims in this action.

III

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[2](...continued)

federal action, the pendency of state action, what each class member would receive and what each member would forfeit, and I'm relying on the fact that the settlement proceeds which were accepted by all class members, including the Epstein plaintiffs, were only paid to shareholders who tendered pursuant to the tender offer and I'm relying on the fact that the Delaware complaint was brought on behalf of all MCA shareholders.

In addition to federal due process concerns, the Delaware Supreme Court's own interpretation of Delaware Chancery Courts Rule 23, as articulated in *Prezant v. De Angelis,* 636 A.2d 915 (Del.1994), requires us to address the Epstein plaintiffs' collateral attack of this settlement on the grounds of inadequate representation. Under Delaware law, issue preclusion attaches only when a question of fact essential to the judgment actually has been litigated and determined by a valid and final judgment. *Messick v. Star Enterprise,* 655 A.2d 1209, 1211 (Del.1995); *Orange Bowl Corp. v. Jones,* 1986 WL 13095, at *2 (Del.Super.1986); *Evans v. Frank E. Basil, Inc.,* 1986 WL 3973, at *2 (Del.Super.1986). The Delaware record shows that the issue of adequacy of representation was not litigated during the settlement proceedings.

The notice to the class members regarding the settlement hearing did not indicate that the issue of adequacy of representation, either by class representative or by class counsel, would be addressed.

Perhaps as a consequence of the absence of notice, the four objectors who participated in the Delaware proceedings did not litigate the question of the adequacy of representation. In addressing the concerns that were litigated by the objectors, the Delaware Chancery Court first determined that the fact that few small shareholders would actually opt out of the settlement, as was their right, did not undermine the validity of the settlement agreement. *In re MCA, Inc. Shareholders Litigation,* 1993 WL 43024, at *4. Second, it determined that it did not need to await the Ninth Circuit's appellate decision in the *Epstein* matter in order to approve the settlement. *Id.* at *5. Third, the Chancery Court concluded that those shareholders who received delayed notice had assumed the risk of such delays in holding their shares under a "street name." *Id.* And finally, it determined that there was insufficient evidence to support the objectors'

claim that the agreement was a collusive means of obtaining settlement of the federal claims. *Id.*

Of these four explicit findings, it is clear that only the second and fourth claim are even tangentially relevant to the claims raised by the Epstein plaintiffs before this court today. The second finding indicated that the valuation of the state claims were not dependant upon the resolution of the federal matter. But the Chancery Court did not assert that the plaintiffs raising the federal claims were adequately represented in the Delaware action. The fourth finding simply makes clear the fact that there was no collusive settlement "deal" between the plaintiffs and attorneys on both sides of the state court matter. The fact that there was no finding of wrongdoing certainly does not preclude a finding that the federal plaintiffs were inadequately represented by the settling class.

In short, none of the Chancery Court's findings address the claim of the plaintiffs before this court today: namely, that the federal plaintiffs were inadequately represented before the Delaware court, and that, consequently, a decision to bind them to the terms of the settlement would violate their rights to due process.

The Epstein plaintiffs correctly argue that to be bound by the settlement decision they are entitled under Delaware law to specific findings that they were adequately represented in the Delaware Chancery Court. Such findings are required in order to bind the federal litigants to the settlement terms. In *Prezant,* 636 A.2d at 924, the Delaware Supreme Court explicitly held that a Court of Chancery is required to "articulate on the record its findings regarding the satisfaction of the Rule 23 criteria and supporting reasoning." Yet the statement offered by the Delaware Chancery Court asserting that the plaintiffs in the action "fairly and adequately protected the interests of the Settlement Class" offers no "supporting reasoning" aside from

that offered to address the challenges raised by the four objectors. No findings exist in the Chancery Court's decision that would indicate that the representation of the absent federal plaintiffs was adequate, because the matter was never actually litigated before that court.

Thus, while the Supreme Court decision in *Matsushita* makes it clear that the objectors will be bound by the judgment of the Delaware court with respect to the matters litigated,[3] the Delaware court's decision cannot be read to bind those whose claims were simply never represented before it. The individual objectors who voluntarily appeared at the fairness hearing were not authorized by the absent class members to represent their interests, nor were they certified by the state to do so. Their appearance at the hearing could therefore not bind other parties with respect to the issue of adequacy of representation.[4] Thus, the majority's determination today also runs against the settled law of Delaware.

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[3] Thus, interpreting the *Matsushita* decision to leave the Epstein plaintiffs' due process claim open for determination on remand does not, as the majority contends, render *Matsushita* an "advisory decision." On the contrary, the Court's decision makes it clear that all participants in the Delaware action will be bound by the judgment in spite of the exclusively federal nature of any claims they sought to raise elsewhere.

[4] This conclusion does not undermine the finality of a class action settlement to any degree greater than that already permissible under the law. In *Prezant,* the Delaware Supreme Court pointed out that prudent class action defendants can foreclose subsequent collateral action absolutely by asking for a judicial finding, supported through reasoning and evidence, that all plaintiffs' "due process right to adequate representation has been satisfied." 636 A.2d at 925-26. Such a finding simply was not made in this case.

IV

Providing the Epstein plaintiffs with the opportunity to raise their due process claims does not, as the majority claims, result in the "collateral second guessing" of the determinations and review of the Delaware courts. Those determinations are valid, and, to the extent that they comply with due process protections afforded by the Constitution, they are binding upon this court. Thus, the result originally reached by the panel on remand was not violative of cooperative federalism or comity. The majority today gives license to those who would run to a favorable and remote state court to obtain settlements premised on bargain-basement valuations of federal claims, even when those claims clearly predominate over potential state causes of action. This result must be especially discouraging to responsible law firms specializing in class action suits, who assiduously and carefully construct subclasses to assure adequate representation of diverse interests, even at the expense of their own fees.

The Epstein plaintiffs seek to raise claims that received neither determination nor review in the Delaware courts. Structural conflicts of interest precluded adequate representation of absent class members. The Epstein plaintiffs were not adequately represented in the Delaware state court proceedings by either the class representatives or the objectors, and their claim was never litigated in Delaware state court. In denying them the right to bring their meritorious federal claims before us, we deny them due process of law. We also significantly diminish the proper oversight role of the judiciary over class action settlements.

I respectfully dissent.